

## CASE # 1

### System Reviews – Evaluation of a Firm’s Risk Assessment

Consider each scenario separately related to System Reviews. It is assumed that each question is separate from the previous or following question within the scenario, unless otherwise indicated.

**Estimated Time to Complete:** 20 Minutes

#### *SCENARIO A*

The following is an excerpt from the General Audit Engagement Checklist (PRP Section 20,400) and various other engagement checklists:

##### **Highest Risk Audit Areas**

Scan the financial statements and profile information. **Given your industry experience, identify at least three accounts or audit areas of highest importance to the type of engagement.** Ordinarily, a reviewer would be expected to identify three or more audit areas of highest importance. The size and complexity of the audit may influence the number of audit areas identified. If fewer than three audit areas are completed in this section, the reviewer should document the facts and circumstances that led them to that conclusion in the notes section. Review the planning and risk assessment for each, consider all of the relevant assertions, and assess whether the firm came to a reasonable risk rating for each assertion... **For each of the accounts or audit areas deemed to be of highest importance, complete the subsequent questions along with the account-specific questions relating to your selection.**

#### *QUESTION 1*

What factors should a reviewer consider when determining the highest risk audit areas?

##### *SOLUTION 1*

**Factors to consider could include, but are not limited to;**

- **Audit area is significant**
- **Whether the audit area contains any specifically identified risks**
- **Whether an identified risk is a fraud risk or other significant risk**
- **The assessed level of the risk of material misstatement**

Consider the auditor’s requirements to design audit procedures in response to the assessed risks of material misstatement at the relevant assertion level in conformity with AU-C 330.06-.07 to assist in identifying higher risk audit areas.

## **SCENARIO B**

The following is an excerpt from the General Audit Engagement Checklist (PRP Section 20,400) and various other engagement checklists:

### **Inherent Risk**

The susceptibility of an assertion about a class of transaction, account balance, or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls. [AU-C sec. 200.14]

### **QUESTION 1**

If the firm did not separately document the assessment of inherent risk, what audit documentation could be used to support the firm's risks of material misstatement at the relevant assertion level?

### **SOLUTION 1**

**The audit standards do not require an auditor to assess inherent risk and control risk separately. The risk of material misstatement is a function of both inherent and control risk, therefore the firm implicitly assessed inherent risk through the firm's risk of material misstatement documentation.**

**Risk of Material Misstatement = Inherent Risk X Control Risk**

**Inherent risk can be a function of complexity, nature, experience and volume of transactions.**

**The firm should document the following to meet the requirements of the standards;**

- the assessment of the *risks of material misstatement* at both the financial statement level and the relevant assertion level. (AU-C sec. 315 par. .33)
- the overall response to address the assessed risks of misstatement at the financial statement level. (AU-C sec. 330 par. .30)
- the identified risks and related controls evaluated for
  - *significant risks.*
  - those circumstances where substantive procedures alone will not provide sufficient appropriate audit evidence. (AU-C sec. 315 par. .33)
- the nature, timing, and extent of the further audit procedures. (AU-C sec. 330 par. .30)
- the linkage of those procedures with the assessed risks at the relevant assertion level. (AU-C sec. 330 par. .30)

## ***QUESTION 2***

When is it appropriate to assess the risk of material misstatement at the account or audit area level?

### ***SOLUTION 2***

It is not appropriate to assess the risk of material misstatement at the account or audit area level.

According to paragraph .05 of AU-C Section 315 – *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, “The auditor should perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement **at the financial statement and relevant assertion levels.**”

Additionally, paragraph .26 of AU-C Section 315 states, “To provide a basis for designing and performing further audit procedures, the auditor should identify and assess the risks of material misstatement at:

- the financial statement level and
- the relevant assertion level for classes of transactions, account balances, and disclosures.”

Therefore, if the firm has assessed risk at the account or audit area level, they have not complied with the relevant auditing standards. In this situation, the reviewer should determine whether the engagement conforms to the relevant professional standards in all material respects and the significance of the issue on the reviewer’s assessment of the firm’s system of quality control. It is likely the engagement is non-conforming and that, at a minimum, a matter for further consideration form should be completed.

## ***QUESTION 3***

If the firm does not test controls, could the risks of material misstatement be low?

### ***SOLUTION 3***

**Yes.**

Land and Building is an example of this circumstance because the inherent risk might be assessed as low. Even though control risk is assessed as high because the auditor does not plan to test the operating effectiveness of controls, the auditor may nevertheless assess the risks of material misstatement as low. Discussion leaders should ask individuals at their table if they can come up with any other examples.

## ***QUESTION 4***

If the firm indicated that the risks of material misstatement at the relevant assertion was set at less than high, what factors should the reviewer consider when concluding whether there was a reasonable basis for the assessment?

#### ***SOLUTION 4***

**Reviewers should consider the following;**

- Documented discussions among the engagement team,
- The key elements of their understanding obtained regarding each aspect of the entity and its environment,
- Understanding of controls and the planned reliance on the operating effectiveness of controls
- Any significant decisions reached (AU-C 315.12 and .33)
- A separately documented inherent risk assessment, if applicable

#### ***QUESTION 5***

What are some common examples of high inherent risk?

#### ***SOLUTION 5***

***Note: this list is not exhaustive***

- Complex relationships with a network of companies
- Off-balance sheet entities, including related parties
- Non-routine accounts or transactions, like accounting for fire damage or acquiring another company
- Accounts that require significant estimates from management e.g. – fair value measurements, goodwill impairment, etc.)

Refer to AU-C 315 Appendix C—Conditions and Events That May Indicate Risks of Material Misstatement (Ref: par. .A40 and .A135) for additional examples and considerations.

#### ***QUESTION 6***

Have you as team captain or team member determined that an engagement should be considered non-conforming based primarily on noncompliance with AU-C 315 – *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* or AU-C 330 – *Audit Procedures*?

#### ***SOLUTION 6***

Discussion leaders should note there is no solution necessarily with this question, however, they should encourage attendees to share their experiences in reviewing the risk assessment procedures performed by their peer review clients. For example, discussion leaders may ask attendees:

- What types of scenarios related to risk assessment led you, the peer reviewer, to determine the engagement was non-conforming?
- Were there instances where you, the peer reviewer, determined the engagement was not non-conforming even though there was non-conformity with the risk assessment standards?
  - In these scenarios, what factors led the reviewer to determine the engagement was not non-conforming?

## CASE # 2

### System Reviews – Writing Deficiencies

Consider each scenario separately related to System Reviews. It is assumed that each question is separate from the previous or following question within the scenario, unless otherwise indicated.

**Estimated Time to Complete:** 20 Minutes

#### *SCENARIO A*

##### *QUESTION 1*

Deficiencies in a system review should be written systemically. What are the required reporting elements of a deficiency or significant deficiency?

##### *SOLUTION 1*

According to PRP Section 4250 *Examples of Deficiencies and Case Studies on Writing Deficiencies*, .02 On a System Review, the deficiencies in the report should be written with a systemic orientation and include

- a. **what the firm's policies and procedures include or exclude (what the system is designed to do or not designed to do), and the particular reference to the applicable requirement of Statements on Quality Control Standards.** The deficiency in the report articulates that the firm's system of quality control is not designed in accordance with professional standards or if designed appropriately, the firm's failure to comply with or document its compliance with an appropriately designed system.
- b. **the systemic cause of the deficiency.** What happened (design failure or pervasive compliance issues) that caused the deficiency? This is often the most difficult area to identify when writing a deficiency, and should be determined in collaboration with the firm. It is extremely important to identify the systemic cause and not just the firm's failure to comply with professional standards in all material respects. This is ultimately what the firm will need to change (the design of its system of quality control or how the firm complies with an appropriately designed system) in order for the deficiency not to recur.
- c. **the failure to comply with professional standards in all material respects (nonconforming) as a result of the deficiency or significant deficiency, if applicable.**
- d. **an identification of the industry and level of service for any deficiencies or significant deficiencies that are determined to be industry specific.**
- e. **an identification of must select industries and practice areas in which nonconforming engagements were noted** as a result of a deficiency or significant deficiency (such as the failure to document several procedures performed on Employee Retirement Income Security Act [ERISA] audits).

f. **grouping issues with the same systemic cause** that meet the threshold of a deficiency, into a single deficiency.

g. **using the term significant deficiencies as a caption before all of the identified deficiencies only when a report with a peer review rating of fail is issued.**

h. if any of the current deficiencies or significant deficiencies were also noted in the firm's previous peer review(s), whether in the prior report or FFC, in either case, that fact should be identified by stating, **"this deficiency was noted in the firm's previous peer review."**

## **QUESTION 2**

From the list below, select the item(s) that the reviewer should avoid when writing a deficiency or significant deficiency.

- a. The partner's name of the engagement resulting in the deficiency.
- b. The number of engagements the situation occurred in.
- c. Long definitions for generally known acronyms, such as CPE.
- d. Writing one deficiency for more than one unrelated issues.
- e. Including recommendations for engagement efficiencies in the deficiency.

## **SOLUTION 2**

**The correct answer is all of the above except C.**

According to PRP Section 4250 *Examples of Deficiencies and Case Studies on Writing Deficiencies*,.03 On a System Review, deficiencies should avoid

a. including **personal preferences**. Deficiencies should be based on professional standards and the firm's design of and its compliance with its system of quality control. Reviewers are occasionally surprised to find that some generally accepted professional standards are, in reality, only a preferred treatment by their firm.

b. referencing **specific individuals, offices, or third-party practice aids**.

c. using undefined acronyms such as GAAP, GAAS, CPE or FASB.

d. identifying the exact number or frequency of occurrence. Terms such as *in some instances* or *frequently* should be used.

e. identifying references to specific technical standards, unless it is critical to the understanding of the deficiency and in relation to the Statements on Quality Control Standards, in which case then the deficiency should be written in a sufficient and succinct manner describing the technical standards in the proper context. Otherwise, the use of the general term *professional standards* should be used.

f. grouping unrelated issues (different systemic causes) into a single deficiency.

g. including poor firm administration or engagement inefficiencies that ordinarily do not create a condition in where there is more than a remote possibility that the firm will not conform with professional standards on accounting and auditing engagements in all material respects.

h. using titles preceding the deficiency that include *design deficiency* or *compliance deficiency* or the applicable functional element of quality control.

## **SCENARIO B**

Natasha Marx is performing the peer review of Stanton & Stanton, LLP, a firm with two partners, 2 managers and 3 professional staff. The firm performs:

- the audit of one defined contribution plan
- 10 reviews
- 5 monthly compilations with disclosures (60 total reports issued)
- 3 monthly compilations without disclosures (36 total reports issued)

One of the partners agreed to perform the audit of the defined contribution plan as a favor to one of its long-time tax clients. To prepare to perform this engagement, the firm obtained an audit guide related to auditing employee benefit plans.

As part of her review, Ms. Marx selected the defined contribution plan, one review engagement, two compilations with disclosures and one compilation without disclosures.

Ms. Marx found no “no” answers on the reviews of the review engagement and compilations; however, there were issues on the audit of the defined contribution plan, including:

- The report was unqualified even though the firm relied upon the trustee certification for the investments.
- The firm failed to conduct testing in the areas of:
  - Participant eligibility
  - DOL compliance
  - Income allocation
  - Related party transactions
- The net assets at the beginning of the year did not agree to the prior year.
- There were no communications with the predecessor auditor and beginning balances were not tested.

Ms. Marx learned the following about the performance of the audit through a discussion with Ben Murphy, the professional staff member assigned to this engagement,

- The engagement partner, Josh Stanton, provided the audit guide and very little other assistance with the engagement.
- Mr. Murphy also acknowledged that he had never participated in an EBP audit and wasn't aware of anyone else within the firm with experience in this area.

- He used the audit guide to create an audit program and design the necessary testing.
- Mr. Stanton's only participation in the review was his final review.

Subsequent to her discussion with Mr. Murphy, Ms. Marx discussed the identified matters with Mr. Stanton, noting the following:

1. The engagement partners had no prior Employee Benefit Plan experience.
2. The firm believes an employee benefit plan audit to be simple, so it decided reviewing the audit guide was sufficient. No continuing professional education or practice aids were obtained. Mr. Stanton did indicate that should the firm decide to grow the practice in this area, it would purchase the practice aids.

### ***QUESTION 1***

What are some of the possible deficiencies resulting in the situation described in Scenario B.

### ***SOLUTION 1***

*This scenario is designed to generate discussion among attendees. In other words, multiple answer may be reasonable given the scenario. Some possible example responses are:*

#### ***Example 1 – Tone at the Top***

**The firm's quality control policies and procedures do not detail appropriate responsibilities for leadership to achieve quality within the firm. A partner accepted an engagement for which the firm did not have the necessary competency to be able to perform in compliance with professional standards. The partner whom accepted the engagement allowed commercial considerations to override the quality of work performed. Additionally, the partner did not obtain the necessary resources to complete the engagement. In our opinion, the tone at the top element is not in compliance with the quality standards, and therefore does not provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.**

#### ***Example 2 – Acceptance and Continuance***

**The firm's quality control policies and procedures were not complied with in reference to acceptance and continuance of specialized engagements. The firm's quality control policies and procedures require evaluation of prospective clients for approval prior to acceptance. During our review, we noted the firm accepted audits of employee benefit plans when it had no experience in that area, its library did not include materials related to such engagements, nor did the firm identify an outside consultant to assist with these standards. In our opinion, this contributed to the audit not being performed in conformity to professional standards in all material respects.**

## CASE # 3

### System Reviews – Repeat Findings

**Consider each scenario separately related to System Reviews. It is assumed that each question is separate from the previous or following question within the scenario, unless otherwise indicated.**

**Estimated Time to Complete:** 10 Minutes

#### *SCENARIO A*

In the prior peer review, the review team identified and documented a finding related to multiple omissions in the report and representation letter of an audit engagement. Per review of three other audit engagements, similar omissions were found in the report and representation letter. It was determined that the systemic cause was lack of a detailed management review, which was deemed a failure to comply with the firm's quality control policies and procedures that require management review of all audit and accounting engagements. In response to the finding, the managing partner asserted he would communicate the results of the peer review to the other partners and staff to increase focus on performing a detailed review of workpapers.

In the current peer review, the firm did not perform a detailed management review of compiled monthly financial statements, which resulted in inconsistent report and financial statement titling. The team captain determined that the firm had not complied with its quality control policies and procedures that require detailed management review of all accounting and auditing engagements, and the result of the prior review was not communicated to firm staff that worked on compilation engagements.

#### *QUESTION 1*

Does this situation result in a repeat finding?

#### *SOLUTION 1*

**Yes. A repeat 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 that is noted during the current review and also on an FFC form in the prior peer review.** Even though the identified issues are different, the underlying cause is lack of detailed supervisory review because the firm had not complied with its quality control policies and procedures.

Per PRP Section 2000, Interpretation 83-2:

*Question*—For System Reviews and Engagement Reviews, what is considered a repeat finding on a finding for further consideration (FFC) form?

*Interpretation*—On System Reviews, a repeat 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 that is noted during the current review and also on a FFC form in the prior peer review. The review team should read the prior review documentation, including the report, letter of response and FFC forms, if applicable, and evaluate whether the firm's planned actions noted on those forms were implemented. If the firm's planned actions to remediate the prior review findings were implemented, and the same finding is occurring, the review team should determine the condition in, or compliance with, the firm's system of quality control that caused the current finding. If it is determined to be the same systemic cause, the FFC form should indicate that similar findings were noted in the prior review. The review team should also consider whether there are findings in other elements of quality control. If the prior remedial actions (corrective actions, implementation plans, or as discussed in the firm's response on the FFC form) appear to be effective, the finding may be caused by some other condition in, or compliance with, the firm's system of quality control. If the systemic cause of the finding is different from that noted in the prior review, it would not be a repeat.

### ***SCENARIO B***

Assuming the same facts as in Scenario A, with the exception that the firm's quality control policies and procedures only required a detailed management review on all audit engagements and did not require review by a suitably experienced staff member on non-audit engagements. Due to the lack of management review, the engagement team did not identify the issues noted on the compilation engagement related to the report and financial statement titling.

### ***QUESTION 1***

Does this situation result in a repeat finding?

### ***SOLUTION 1***

**No. This is a design related finding whereas Scenario A described a compliance finding, and as such would not be deemed a repeat even though it led to similar issues as identified in the prior peer review.**

Per PRP Section 2000, Interpretation 96n-1:

If the systemic cause of the deficiency or significant deficiency is different from that reported in the prior review, it would not be a repeat.

## CASE # 4

### System Reviews – Engagement Selection

Consider each scenario separately related to System Reviews. It is assumed that each question is separate from the previous or following question within the scenario, unless otherwise indicated.

**Estimated Time to Complete:** 15 Minutes

Farmer & Brown, Incorporated (FBI), is performing a System Review for Mage Indigo & Belfast, LLP (MIB) for the year-ended June 30, 2018. MIB included the personnel statistics below on its Peer Review Information Form (PRI) and provided FBI with an engagement listing to assist with its risk assessment and engagement selections.

<i>Personnel that provide A&amp;A Services</i>	<i>Total</i>	<i>Office 1</i>	<i>Office 2</i>
Partners	4	4	0
Other professionals	<u>30</u>	<u>20</u>	<u>10</u>
Total	<u>36</u>	<u>24</u>	<u>12</u>

Each partner in Office 1 supervises audits subject to Statements on Auditing Standards (SASs) as the highest level of service. Each partner issues compilation engagements with disclosures, and certain partners specialize in EBP, FDICIA, Single Audits, and Other GAS engagements. The reviewer noted during planning discussions that the partners in Office 2 only provide tax services, however some staff from Office 2 assist with EBP audits as needed.

The composition of A&A engagements in the firm is approximately 35% EBP, 25% Single Audit, 2% FDICIA, 5% Other GAS, 23% Other SAS and 10% compilations with disclosures. The team captain obtained a schedule of all A&A engagements and noted the percentage of A&A hours supervised and types of higher risk engagements associated with each partner.

<b>Partner</b>	<b>% of A&amp;A Hours Supervised</b>	<b>High-Risk Practice Areas or Industries Supervised</b>
1A	25	EBP
1B	10	EBP; FDICIA; Single Audit; Other GAS
1C	30	Single Audit; Other GAS-Non Profit
1D	35	Single Audit; EBP

The firm had relatively low personnel and client turnover since its most recent peer review. The prior peer review was a *pass* report with one FFC for failing to use appropriate practice aids to assess independence on a Yellow Book engagement supervised by partner 1C. Partner 1D is designated as the individual responsible for the firm's system of quality control and performs EQCR for all of the firm's higher risk engagements. MIB is using the most current library of QCM from a third-party provider.

### **QUESTION 1**

What inherent and control risk factors should the team captain consider when selecting engagements for review?

### **SOLUTION 1**

**Note: Risk assessment involves many considerations and professional judgment of the peer reviewer. This question is intended to probe discussion among attendees and the answers may vary given the limited amount of information in the fact pattern.**

Discussion of inherent risk factors may include:

- circumstances arising within the firm, such as partner 1B that has a wide variety of specialized industries but supervises a relatively low portion of the firm's A&A practice,
- circumstances outside the firm that impact the firm's clients, or
- variances that occurred from engagement to engagement such as the implementation of recent accounting pronouncements.

Discussion of control risk factors may include:

- Evaluating the reviewed firm's quality control policies and procedures and discuss with the firm if it considered the guidance in AICPA Accounting and Auditing Practice Aid "*Establishing and Maintaining A System of Quality Control for a CPA Firm's Accounting and Auditing Practice*".
- Evaluating whether the reviewed firm has adopted appropriately comprehensive and suitably designed policies and procedures for each of the elements of quality control in the context of the firm's overall control environment and the inherent risk embodied in its accounting and auditing practice.

Excerpt from PRPM 2000, Interpretation 52-1

#### ***Inherent Risk Factors***

*In assessing inherent risk factors, the reviewer should consider*

- *circumstances arising within the firm (for example, the firm or individual partners have engagements in several specialized industries);*
- *circumstances outside the firm that impact the firm's clients (for example, new professional standards or those being applied initially for one or more clients, changes in regulatory requirements, adverse economic developments in an industry in which one or more of the firm's clients operate, or significant developments in the client's organization); and*
- *variances that may occur from year to year, engagement to engagement or, perhaps, from partner to partner, within the firm (for example, inherent risk will always be higher for an audit of a company or organization operating*

*in a high-risk industry than for a compilation of financial statements without disclosure for a company operating in a noncomplex industry; and there are many situations between these two extremes).*

### ***Control Risk Factors***

*Assessing control risk requires reviewers to evaluate the effectiveness of the reviewed firm's quality control policies and procedures in preventing the performance of engagements that do not comply with professional standards. When assessing control risk, the review team should evaluate the reviewed firm's quality control policies and procedures and discuss with the firm if it considered the guidance in AICPA Accounting and Auditing Practice Aid Establishing and Maintaining A System of Quality Control for a CPA Firm's Accounting and Auditing Practice. The reviewer should evaluate whether the reviewed firm has adopted appropriately comprehensive and suitably designed policies and procedures for each of the elements of quality control in the context of the firm's overall control environment and the inherent risk embodied in its accounting and auditing practice.*

*The assessed levels of risk are the key considerations in deciding the number and types of engagements to review and, where necessary, offices to visit. Through the assessment of risk, the reviewer determines the coverage of the firm's accounting and auditing practice that will result in an acceptably low peer review risk. Engagements selected should provide a reasonable cross-section of the firm's accounting and auditing practice, with a greater emphasis on those engagements in the practice with higher assessed levels of peer review risk.*

*Reviewers must document, as part of the Summary Review Memorandum (SRM), the risk assessment of the firm's accounting and auditing practice and its system of quality control, the number of offices and engagements selected for review, and the basis for that selection in relation to the risk assessment.*

*To effectively assess risk of the firm's accounting and auditing practice and its quality control policies, risk assessment documentation should not only address the engagements selected and the reasoning behind that selection, but also the environment of the firm and its system of quality controls. Some factors that should be considered in assessing risk include the following:*

- The relationship of the firm's audit hours to total accounting and auditing hours*
- Size of the firm's major engagement(s), relative to the firm's practice as a whole*
- Initial engagements and their impact on the firm's practice*
- The industries in which the firm's clients operate, especially the firm's industry concentrations*
- The results of the prior peer review*

- *The results of any regulatory or governmental oversight or inspection procedures*
- *The results of the team captain's assessment of the firm's design of and compliance with quality controls in accordance with SQCS No. 8*
- *Risk level of the engagements performed (For example, does the firm perform audits of employee benefit plans, entities subject to the Single Audit Act, entities subject to SEC complex independence requirements, and others under Government Auditing Standards, HUD-regulated entities, and others with high-risk features or complex accounting or auditing applications?)*
- *Have there been any major changes in the firm's structure or personnel since the prior peer review?*

## **QUESTION 2**

Is there a requirement for the team captain to reach a certain level of partner coverage? Where should the team captain document considerations of partner coverage in relation to the engagements selected?

## **SOLUTION 2**

**When selecting engagements for review, there is not a specific threshold requirement for the extent of engagements or partner coverage a reviewer should achieve.** However, reviewers are required to document their risk assessment of the firm's accounting and auditing practice and its system of quality control, the number of offices and engagements selected for review, and the basis for that selection in relation to the risk assessment.

**In the 'Other Planning' section of the SRM (PRP Section 4800, item I.), peer reviewers are required to document the planned selection of office(s) and engagement(s) to reduce peer review detection risk to an acceptably low level.** That documentation should also include how the scope covered a reasonable cross-section of the reviewed firm's accounting and auditing practice, with greater emphasis on engagements with higher assessed levels of peer review risk.

Paragraph .59 of the Standards states "Engagements selected for review should provide a reasonable cross section of the reviewed firm's accounting and auditing practice, with greater emphasis on those engagements in the practice with higher assessed levels of peer review risk. Examples of the factors to consider when assessing peer review risk at the engagement level include size; industry area; level of service; personnel (including turnover, use of merged-in personnel, or personnel not routinely assigned to accounting and auditing engagements); communications from regulatory, monitoring, or enforcement bodies; extent of non-audit services to audit clients; significant clients' fees to practice office(s) and partner(s); and initial engagements (see interpretations)."

Additionally, Interpretation No. 59-2 states "Other examples of factors to consider when assessing peer review risk at the engagement level follow. This list is for illustrative purposes only, and does not include all possible inherent and control risk factors, nor is the

peer reviewer required to consider every item on the list when assessing inherent and control risk:

- Engagement size, in terms of the hours required to plan and perform it
- Engagements involving experienced personnel hired from other firms, and partners who also have office, regional or firm-wide management, administrative, or functional responsibilities
- Engagements where work on segments has been referred to other firms, foreign offices, domestic or foreign affiliates, or correspondents
- Engagements where one or more affiliated entities (for example, parent companies and subsidiaries or brother and sister companies) constitute a large portion of the firm's overall clientele
- Engagements identified in the firm's quality control System or guidance material as having a high degree of risk
- Engagements where departures from professional standards and failure to comply with the firm's quality control policies and procedures were noted in the preceding year's monitoring procedures
- Engagements in industries where the firm has experienced high instances of litigation, proceedings, or investigations
- Engagements affected by recently implemented revisions of the firm's quality control policies and procedures
- Engagements affected by newly effective professional standards
- Clients in industries in poor financial condition
- Clients in industries with complex or sophisticated transactions
- Engagements from merged-in practices
- Engagements subject to Government Auditing Standards
- Engagements subject to the Employee Retirement Income Security Act of 1974 (ERISA)
- Engagements subject to the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA)
- Audits of securities and commodities broker-dealers
- Examinations of controls relevant to both a service organization and its user entities
- Engagements subject to SEC independence rules

## CASE # 5

### System Reviews – Non-Conforming Engagements

Consider each scenario separately related to System Reviews. It is assumed that each question is separate from the previous or following question within the scenario, unless otherwise indicated.

**Estimated Time to Complete:** 15 Minutes

#### *SCENARIO A*

Luke Berry is the team captain for the review of Pinson, Maye and Robinson LLP (PMR). During his review of an audit engagement for a construction company, Mr. Berry answered several questions within the ‘Conclusions’ section of the engagement checklist as “Yes”.

#### *QUESTION 1*

Should the engagement be considered non-conforming?

#### *SOLUTION 1*

**The presumption would be that any “YES” answers to the questions within the “Conclusions” section of the engagement checklist should result in a nonconforming engagement.**

These questions ask that based on your review of the work performed, including other inquiries and observations, did anything come to your attention that caused you to believe that, among other items:

- There are errors or omissions, individually or in the aggregate, in the financial statements (including disclosures) related to requirements under the applicable financial reporting framework that exceed materiality established by the auditor, and the auditor’s report was not appropriately modified.
- The auditor failed to perform planning, including documentation and an appropriate risk assessment, in accordance with current professional standards, which resulted in inadequate procedures performed.
- The auditor’s report is not presented in accordance with the most current applicable professional standards and regulatory requirements (does not contain the critical elements), including evidence of firm reliance on outdated standards.

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#### *QUESTION 2*

Can a reviewer answer a question within the “Conclusions” section of an engagement checklist as “Yes” and still conclude that the engagement conforms to professional standards in all material respects?

### ***SOLUTION 2***

**Yes, however, this should only be in rare circumstances as a presumption exists where if one of the questions in the ‘Conclusions’ section of the engagement checklist is answered ‘Yes’ then the engagement should be considered non-conforming.**

There is a question within the “Conclusions” that asks the reviewer: “If any of the preceding questions were answered “Yes”, but you concluded that the firm performed or reported on this engagement in conformity with applicable professional standards in all material respects, explain why.”

This should give the reviewer an opportunity to explain why a condition existed where one of the questions within the ‘Conclusions’ section should be answered “Yes” but the engagement should still not be considered non-conforming. When developing these questions, the Peer Review Board decided these situations should be rare.

### ***QUESTION 3***

Which of the following item(s) is (are) false when the team captain identifies a non-conforming engagement?

- a) The non-conforming engagement should be discussed with the firm when identified and during the closing meeting with the firm.
- b) The team captain is required to include a deficiency in the peer review report when multiple non-conforming engagements are noted.
- c) The team captain should typically expand scope to determine the pervasiveness of the non-conforming engagement.
- d) The team captain is not required to review documentation of any firm actions already taken to address the non-conforming engagement.

### ***SOLUTION 3***

**The correct answers are choices B & D.**

For option A, Standards paragraph .67 states, “If the reviewer concludes that an engagement is not performed or reported on in conformity with applicable professional standards in all material respects, the team captain or review captain should promptly inform an appropriate member of the reviewed firm on an MFC form.

Furthermore, standards paragraph .91 states, “Prior to issuing his or her report or finalizing MFC and FFC form(s), if applicable, the team captain should communicate his or her conclusions to senior members of the firm at a closing meeting. The team captain should discuss the following during the closing meeting preliminary peer review results, including any matters, findings, deficiencies or significant deficiencies, and the type of report expected to be issued if determinable at this point.”

For option B, standards paragraph .70(c) states, “A deficiency is one or more findings that the peer reviewer has concluded, due to the nature, systemic causes, pattern, or

pervasiveness, including the relative importance of the finding to the reviewed firm's system of quality control taken as a whole, could create a situation in which the firm would not have reasonable assurance of performing or reporting in conformity with applicable professional standards in one or more important respects."

Further, Standards paragraph .89 states, "A report with a peer review rating of pass with deficiencies should be issued when the team captain concludes that the firm's system of quality control for the accounting and auditing practice has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects with the exception of a certain deficiency or deficiencies that are described in the report."

Therefore, there is no explicit requirement that a reviewer issue a deficiency when multiple non-conforming engagements exist, however, it may be appropriate in the circumstances.

For option C, Standards interpretation 67-2 states, "If the firm has taken action, ordinarily the review team should review documentation of such actions (for example, omitted procedures performed, reissued report and financial statements, or notification to users to discontinue use of previously issued reports) and consider whether the action is appropriate. If the firm has not taken action, the review team should consider whether the planned actions are appropriate (genuine, comprehensive, and feasible)."

For option D, Standards interpretation 67-2 states, "The firm should respond to all matters communicated on an MFC form, findings communicated on an FFC form and deficiencies, or significant deficiencies communicated in the peer review report."

#### ***QUESTION 4***

Which of the following should the reviewer consider if the firm's responses to any non-conforming engagement are not appropriate?

- A) Consider a "Tone at the Top" deficiency.
- B) Request the firm revise its responses to the MFC/FFC.
- C) Discuss the appropriateness of the responses during the Exit Conference.
- D) All of the above.

#### ***SOLUTION 4***

**The correct answer is D, "All of the above".**

For option A, PRP Section 3100 *Supplemental Guidance* states, "In a system review, if the team captain or RAB concludes that the firm's response and consideration of the applicable standards is not appropriate to address the nonconforming engagement, the team captain should evaluate whether there are other weaknesses in the firm's system. For example, an inappropriate response may be indicative of a potential failure to comply with the leadership or tone at the top element in the firm's system of quality control. A failure to properly consider how to address nonconforming engagements may indicate an internal firm culture that fails to promote that quality is essential in performing engagements."

For option B, Interpretation 67-2 states, “[For nonconforming engagements, reviewers or administering entities should not instruct firms to perform omitted procedures, reissue accounting or auditing reports, or have previously issued financial statements revised and reissued because those are decisions for the firm and its client to make. However, the administering entity can require the firms to make and document appropriate considerations regarding such engagements as a condition of acceptance of the peer review.” Therefore, the reviewer should also require the firm to make and document appropriate considerations regarding such engagements.

For option C, Standards paragraph .92 states, “An exit conference will be held after the firm has responded to the MFC forms, FFC forms, and deficiencies or significant deficiencies in the report and the team captain has assessed whether the responses are appropriate and has considered any additional impact to the peer review results, and may be held via teleconference.”

Additionally, interpretation 67-2 states, “If the firm has not taken action, the review team should consider whether the planned actions are appropriate (genuine, comprehensive, and feasible).”

## CASE # 6

### System Reviews – Aggregating Matters for Further Consideration (MFCs)

Consider each scenario separately related to System Reviews. It is assumed that each question is separate from the previous or following question within the scenario, unless otherwise indicated.

**Estimated Time to Complete:** 15 Minutes

#### *SCENARIO A*

Rey Antilles of Rebel Alliance, LLC (RA) is engaged to serve as team captain and perform the peer review of Galactic Empire, LLP (GE) for the year-ended 12/31/2017. GE provided RA with the following list of engagements in the scope of the review:

- 1 Single Audit subject to Government Auditing Standards (GAS)
- 1 Limited Scope-Defined Contribution Plan audit (excluding 403(b) plans)
- 2 Audits of retail companies subject to Statements on Auditing Standards (SAS)
- 1 Audit of a distribution company subject to SAS
- 4 Audits of construction contractors subject to SAS

Rey performed an appropriate risk assessment and noted the EBP and distribution company audits were the only engagements new to the firm. Rey selected one from each type of engagement (5 in total) and based on her initial assessment of the work performed, prepared an MFC form for each of the following matters identified to discuss with GE during fieldwork:

- **MFC-1:** Missing documentation related to the sampling methodology used in the only Single Audit engagement, which appeared to be isolated after seeing sufficient documentary evidence in other engagements selected.
- **MFC-2:** The audit file for the distribution company did not contain sufficient documentation related to risk assessment and linkage of procedures performed with risks identified.
- **MFC-3:** The audit file for the EBP engagement did not contain sufficient documentation related to relying on a SOC 1 report to reduce substantive procedures.

#### *QUESTION 1*

What should Rey do first to assess whether the matters identified should be elevated to a finding and documented on a Finding for Further Consideration (FFC) form?

- a) Determine the systemic cause
- b) Determine if the engagements are non-conforming
- c) Review any FFCs from the firm's prior review
- d) Determine the pervasiveness of the matters identified

### ***SOLUTION 1***

**Rey's first task is to determine if a systemic cause exists under the circumstances that resulted in the matters identified (answer a).**

#### **Per PRP Section 1000, Paragraph .83**

*When the review team is faced with an indication that a matter(s) could be a finding, the review team's first task in such circumstances, in collaboration with the firm, is to determine the systemic cause (see interpretations).*

#### **Per PRP Section 2000, Interpretation 83-1**

*The evaluation of a firm's system of quality control is the primary objective of a System Review and the basis for the peer review report.*

*As such, when a reviewer in a System Review discovers a matter, including an engagement that was not performed or reported in conformity with applicable professional standards in all material respects, he or she should avoid considering the type of report to issue until the systemic cause of the matter (to determine if it rises to the level of a finding, deficiency or significant deficiency) is identified, where it is reasonably possible to do so.*

### ***QUESTION 2***

When discussing the matters identified, the managing partner of GE indicated that MFC-1 was simply an oversight by the audit team and isolated to that engagement; MFC-2 resulted from an insufficient final workpaper review prior to issuance; and MFC-3 resulted from the engagement team's lack of understanding of professional standards related to EBP engagements.

Based on the reasoning of the managing partner, is it appropriate for Rey to aggregate some, or all of these matters to a single FFC? Explain your rationale.

### ***SOLUTION 2***

**No. Matters may be combined to a single FFC if they result from the same failure in the firm's system of quality control (i.e. systemic cause).** Based on the facts presented, the systemic cause for each matter appears to be different and therefore should be, at a minimum, considered for elevation to separate FFCs.

#### **Per PRP Section 1000, Paragraph .83**

*When the review team is faced with an indication that a matter(s) could be a finding, the review team's first task in such circumstances, in collaboration with the firm, is to determine the systemic cause (see interpretations). Causes that might be systemic and might affect the type of peer review report issued include, but are not limited to, the following:*

- a. The failure related to a specialized industry practice, and the firm had no experience in that industry and made no attempt to acquire training in the industry or to obtain appropriate consultation and assistance.*

*b. The failure related to an issue covered by a recent professional pronouncement, and the firm had failed to identify, through professional development programs or appropriate supervision, the relevance of that pronouncement to its practice.*

*c. The failure should have been detected if the firm's quality control policies and procedures had been followed.*

*d. The failure should have been detected by the application of quality control policies and procedures commonly found in firms similar in size or nature of practice. That judgment can often be made by the reviewer based on personal experience or knowledge; in some cases, the reviewer will wish to consult with the administering entity before reaching such a conclusion.*

## **SCENARIO B**

Assume the same fact pattern as Scenario A with the following additional information:

In Rey's initial assessment, she determined that the firm's quality control policies and procedures (QCPP) related to engagement performance were suitably designed and required that third-party practice aids are followed and modified as necessary for all engagements performed by the firm.

When discussing the matters identified, the managing partner agreed that the issue identified in MFC-1 was isolated to that engagement, resulting from a simple omission of documentation related to the sampling methodology in the audit program. The managing partner then noted that the issues on MFC-2 and MFC-3 were associated with engagements that were new to the firm, however upon further questioning, could have been avoided if the engagement teams did a better job following and tailoring practice aids developed by their third-party provider.

### **QUESTION 1**

Based on the additional facts outlined, is it appropriate for Rey to aggregate some, or all of these matters to a single FFC? Explain your rationale.

### **SOLUTION 1**

**Yes. Multiple matters that share the same systemic cause can be aggregated to a single FFC form.** Based on the facts outlined, Rey should consider combining each of the matters to be, at a minimum, elevated to a finding due to the firm's failure to comply with its QCPP that require third-party practice aids to be followed and modified as necessary for all engagements.

While MFC-1 was initially thought to be an isolated issue, further discussion with the managing partner indicated that the systemic cause for each of the matters is failing to comply with the firm's QCPP. Thus, it is important that reviewers not accept "oversight" or "isolated" as the firm's response without further investigation.

### **Per PRP Section 2000, Interpretation 83-1**

*The evaluation of a firm's system of quality control is the primary objective of a System Review and the basis for the peer review report.*

*As such, when a reviewer in a System Review discovers a matter, including an engagement that was not performed or reported in conformity with applicable professional standards in all material respects, he or she should avoid considering the type of report to issue until the systemic cause of the matter (to determine if it rises to the level of a finding, deficiency or significant deficiency) is identified, where it is reasonably possible to do so.*

*Reviewers in a System Review must think of matters as symptoms of weaknesses in the firm's system of quality control. Further, reviewers, in collaboration with the firm, must make a good faith effort to try to identify the systemic cause for those matters to determine if they rise to the level of a finding. A finding has a systemic definition; 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. With a finding, the reviewer is considering more than just the "matter;" they are considering the condition (that is, systemic cause) that resulted in the matter(s) occurring. Otherwise said, the reviewer must determine why the matters occurred. Upon further evaluation, a finding may rise to a systemically oriented deficiency or significant deficiency.*

*The system risks identified as part of the completion of the Guidelines for Review and Testing of Quality Control Policies and Procedures (sections 4500 to 4650) will be a helpful resource for reviewers in assessing the systemic cause. The assessment of the systemic cause should consider that separate matters that are exactly the same may result from completely different quality control weaknesses in the firm.*

*To properly assess the systemic cause, reviewers should not accept "oversight" or "isolated" as the firm's response without further investigation. Accordingly, the firm should provide sufficient detail for the reviewer to understand what caused the matter. For example, the failure to follow the firm's practice aid for a particular area may have been an isolated occurrence; however, failure to follow the practice aid would still be identified as the systemic cause resulting in the matter. Further guidance is provided in Interpretation 84-1 to assist reviewers in determining if the matter is isolated.*

**PRP Section 2000, Interpretation 79-1**

*Question—Paragraph .79 of the standards indicates that in the absence of findings or deficiencies in the engagements reviewed, the reviewer may still conclude that there are conditions in the design of the firm's system of quality control that could create a situation in which the firm would not have reasonable assurance of performing or reporting in conformity with applicable professional standards. When would a design matter or compliance with a functional area, by itself, result in a peer review rating of pass with deficiencies or fail?*

*Interpretation—A design matter or compliance with a functional area, by itself, may result in a peer review rating of pass with deficiencies or fail when one or more conditions are present in the firm’s system of quality control and the reviewer has concluded that the conditions could create a situation in which the firm would not have reasonable assurance of performing or reporting in conformity with applicable professional standards in one or more respects.*

- *Examples may include but are not limited to the failure to establish or comply with policies and procedures designed to provide the firm with reasonable assurance that the internal culture is based on recognition that quality is essential in performing engagements. This may be identified by firm leadership failure to have a quality control document, failure to appropriately respond to findings in a regulatory investigation, failure to have a timely peer review, and so on.*
- *the firm and its personnel comply with relevant ethical requirements. This may be identified by failure to obtain independence confirmations from all personnel, failure to inform personnel on a timely basis of changes to the list of clients and related entities, failure to address potential breaches of independence, and so on.*
- *the firm will undertake or continue relationships and engagements only when the firm is competent to perform the engagements. This may be identified by failure to have policies and procedures in place to require evaluation of the nature of the services to be provided, evaluation of the firm’s resources to provide the services, evaluation of the need to engage a third party to assist in new industries, and so on.*
- *the firm has sufficient personnel with the competence, capabilities, and commitment to ethical principles necessary to perform engagements in accordance with professional standards. This may be identified by failure to have policies and procedures requiring personnel to maintain a CPA license, comply with industry specific CPE requirements, ensure appropriate industry experience on engagement teams, and so on.*
- *the firm’s compliance with all areas of the firm’s system of quality control is effectively monitored. This may be identified by lack of monitoring of appropriate CPE for all firm personnel, lack of monitoring of functional areas in the firm’s peer review year, failing to appropriately respond to issues identified during engagement inspections, and so on.*

## ***QUESTION 2***

Should an FFC be issued for MFC 1? Explain your rationale.

***SOLUTION 2***

**As the issue is isolated with no apparent systemic cause, an FFC is most likely not appropriate.**

Per paragraph .70(b), 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 MFC 1, in this scenario, does not result from a condition in the reviewed firm's system of quality control or compliance with it, it is most likely appropriate that this item does not get elevated to an FFC form.

## CASE # 7

### System Reviews – Identification of Systemic Causes

**Consider each scenario separately related to System Reviews. It is assumed that each question is separate from the previous or following question within the scenario, unless otherwise indicated.**

**Estimated Time to Complete:** 15 Minutes

Luke Maye, of the accounting firm Maye & Maye, LLP, agreed to perform the audit of a non-carrying broker-dealer. Mr. Maye did not audit any other non-carrying broker-dealers and did not have the requisite experience to perform such an audit. As part of his audit, Mr. Maye did not have an EQCR as required by PCAOB standards.

During Maye & Maye, LLP's peer review, the engagement was selected for peer review procedures. The peer reviewer completed an FFC related to the non-carrying broker-dealer engagement; the systemic cause of this FFC is listed below:

*“The firm did not comply with its policies and procedures regarding engagement acceptance and engagement performance.”*

#### **QUESTION 1**

Who is responsible for determining the systemic cause for any matter identified?

#### **SOLUTION 1**

**According to Standards paragraph .75, “The team captain, in collaboration with the firm, should determine the systemic cause of matters identified.”**

Proper determination of the systemic cause is essential to assist the firm with identifying the appropriate remediation of the firm's system of quality control. To conclude on the results of a peer review, the review team must aggregate the matters noted during the peer review and determine whether the matters were the result of the design of the reviewed firm's system of quality control or the failure of its personnel to comply with the firm's quality control policies and procedures.

To properly assess the systemic cause, reviewers should not accept “oversight” or “isolated” as the firm's response without further investigation. Accordingly, the firm should provide sufficient detail for the reviewer to understand what caused the matter. For example, the failure to follow the firm's practice aid for a particular area may have been an isolated occurrence; however, failure to follow the practice aid would still be identified as the systemic cause resulting in the matter.

The system risks identified as part of the completion of the Guidelines for Review and Testing of Quality Control Policies and Procedures (sections 4500 to 4650) will be a helpful resource for reviewers in assessing the systemic cause.

## **QUESTION 2**

How should the systemic cause in the scenario be written to indicate a true systemic cause(s)?

### **SOLUTION 2**

**The statement above is very general and appears to encompass two issues: engagement acceptance and engagement performance. It would be more appropriate to separate the two issues as follows:**

- 1. The firm did not comply with its engagement acceptance procedures because the selected engagement related to a specialized industry practice, and the firm had no experience in that industry and made no attempt to acquire training in the industry or to obtain appropriate consultation/assistance.**
- 2. The firm did not comply with its engagement performance policies and procedures by not performing an EQCR as required by PCAOB standards.**

## **QUESTION 3**

What is the risk of writing a systemic cause that does not truly encompass the identified issue(s)?

### **SOLUTION 3**

**A poorly written systemic causes creates a risk that repeat findings, deficiencies, or significant deficiencies are improperly identified (or not identified at all).**

**Additionally, failure to properly identify the systemic cause increases the risk that the firm will not correct the underlying issue and therefore increase the likelihood that the firm will repeat the mistake in the future, including in the firm's next peer review.**

When systemic causes are vague or written too generally, it is difficult to identify a repeat finding. In the case of a repeat finding, the review team should read the prior review documentation, including the report, letter of response and FFC forms, if applicable, and evaluate whether the firm's planned actions noted on those forms were implemented. If the firm's planned actions to remediate the prior review findings were implemented, and the same finding is occurring, the review team should determine the condition in, or compliance with, the firm's system of quality control that caused the current finding.

Finally, failure to correct the systemic causes of any matter identified increases the risk the firm will have consecutive non-pass peer review reports. A firm that has consecutive non-pass reports may be referred to the Peer Review Board and their enrollment in the program could be terminated.

### **Per Interpretation 83-2:**

*On System Reviews, a repeat 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 that is noted during the current review and also on a FFC form in the prior peer review.*

## CASE # 8

### System Reviews – Firm responses to Non-Conforming Engagements

Consider each scenario separately related to System Reviews. It is assumed that each question is separate from the previous or following question within the scenario, unless otherwise indicated.

**Estimated Time to Complete:** 15 Minutes

Harding Accounting Firm is currently undergoing a peer review. The team captain has deemed the selected non-carrying broker dealer engagement is non-conforming, as the working papers do not document the auditor's compliance with qualifications of an independent public accountant under Rule 17a-5(f)(1).

#### ***QUESTION 1***

How should the team captain inform Harding Accounting Firm of the non-conforming engagement?

#### ***SOLUTION 1***

**The team captain should promptly inform Harding of the non-conforming engagement on a MFC form.**

*Per Excerpt of PRP Section 2000, Interpretation 67-1:*

*“Question—Paragraphs .67 and .109 of the standards notes that the team captain or review captain should promptly inform the firm when an engagement is not performed or reported on in conformity with applicable professional standards in all material respects and remind the firm of its responsibilities under professional standards to take appropriate actions. How is this communication made?”*

*Interpretation—If the reviewer concludes that an engagement is not performed or reported on in conformity with applicable professional standards in all material respects, the team captain or review captain should promptly inform an appropriate member of the reviewed firm on an MFC form...”*

#### ***QUESTION 2***

What other responsibilities does the team captain have with respect to the non-conforming engagement?

#### ***SOLUTION 2***

According to Interpretation 67-2, Reviewers or administering entities should not instruct firms to perform omitted procedures, reissue accounting or auditing reports, or have previously issued financial statements revised and reissued because those are decisions for the firm and its client to make.

However, the administering entity can require the firms to make and document appropriate considerations regarding such engagements as a condition of acceptance of the peer review.

The firm's response may affect other monitoring actions the administering entity's peer review committee may impose, including actions to verify that the firm adheres to the intentions indicated in its response. If the firm has taken action, ordinarily the review team should review documentation of such actions (for example, omitted procedures performed, reissued report and financial statements, or notification to users to discontinue use of previously issued reports) and consider whether the action is appropriate. If the firm has not taken action, the review team should consider whether the planned actions are appropriate (genuine, comprehensive, and feasible).

On a System Review, the team captain should consider expanding scope to determine the pervasiveness of the nonconforming engagements. The extent of the nonconforming engagements is considered when determining the systemic cause and whether the matter should be elevated to a finding, deficiency, or significant deficiency.

### **QUESTION 3**

What is Harding Accounting Firm's responsibility related to the non-conforming engagement?

### **SOLUTION 3**

**The reviewed firm (firm) should make appropriate considerations to address engagements that are identified during the peer review that are not performed or reported on in conformity with applicable professional standards in all material respects (nonconforming). The primary responsibility is on the firm to follow professional standards to address these types of engagements.**

*Per PRP Section 3100 - Responding to Engagements Not Performed or Reported on in Conformity With Applicable Professional Standards in all Material Respects (Nonconforming)*

*The firm should make and document comprehensive assessments about whether it is necessary to perform omitted procedures, or whether a material reporting error necessitates reissuance of an accounting or auditing report, revision to the financial statements, or remediation of the subsequent engagement. The firm should thoroughly consider the continued reliance by third party users on reports issued and procedures performed. Particularly, the firm should consider the expectations of regulatory bodies that the firm will perform the omitted procedures or correct reports in a timely manner.*

*The firm is expected to follow applicable professional standards regarding documentation of the omitted procedures, if performed, document performance or reissuance considerations, and provide a response to the peer reviewer. The firm's response should be documented on the MFC form that appropriately describes the most significant matters indicating the engagement is nonconforming.*

*Peer reviewers and administering entities should not require or instruct reviewed firms to perform omitted procedures, reissue accounting or auditing reports, or to have previously issued financial statements revised and reissued because those are decisions for the firm and its client to make. Firms are only required to remediate as appropriate in accordance with professional standards and are not expected to recall reports or perform additional procedures in every scenario. In general, if firms can articulate their consideration of the professional standards and why the actions taken or planned are appropriate, it would not result in a tone at the top deficiency. Firms are discouraged from defaulting to a response of “we’ll fix it on the next engagement” without thought behind that response. It may be the appropriate response but firms should be able to articulate why that is the appropriate response.*

*Per PRP Section 2000, Interpretation 67-1:*

*Question—Paragraphs .67 and .109 of the standards notes that the team captain or review captain should promptly inform the firm when an engagement is not performed or reported on in conformity with applicable professional standards in all material respects and remind the firm of its responsibilities under professional standards to take appropriate actions. How is this communication made?*

*Interpretation—If the reviewer concludes that an engagement is not performed or reported on in conformity with applicable professional standards in all material respects, the team captain or review captain should promptly inform an appropriate member of the reviewed firm on an MFC form. The team captain or review captain should remind the reviewed firm of its responsibilities under professional standards to take appropriate actions as addressed in the following professional standards, as applicable:*

- *AU-C section 560, Subsequent Events and Subsequently Discovered Facts (AICPA, Professional Standards)*
- *SSARS No. 19, Framework for Performing and Reporting on Compilation and Review Engagements (AICPA, Professional Standards, AR sec. 60, 80, and 90), or SSARS No. 21, Statements on Standards for Accounting and Review Services: Clarification and Recodification (AICPA, Professional Standards, AR-C sec. 60, 70, 80, and 90) as applicable*
- *AU-C section 585, Consideration of Omitted Procedures After the Report Release Date (AICPA, Professional Standards)*
- *The “Breach of Independence” interpretation (AICPA, Professional Standards, ET sec. 1.298.010)*
- *The reviewed firm should investigate the issue questioned by the review team and determine what timely action, if any, should be taken, including actions planned or taken to prevent unwarranted continued reliance on its*

*previously issued reports. The reviewed firm should then advise the team captain or review captain of the results of its investigation, including parties consulted, and document the actions planned or taken or its reasons for concluding that no action is required as follows:*

- *In the firm's response to the MFC form*
- *In the firm's response to the FFC form, if applicable*
- *In the firm's letter of response to deficiencies and significant deficiencies identified in the report, if applicable*

*The firm is also expected to make a representation in its representation letter to the team or review captain confirming it will remediate nonconforming engagements as stated by the firm on its MFC forms, FFC forms, or letter of response, as applicable.*

#### **QUESTION 4**

What is reviewer's responsibility related to the firm's response to the non-conforming engagement?

#### **SOLUTION 4**

Subsequent to the closing meeting and prior to the exit conference, the review team should review the firm's response to any nonconforming engagements. Typically, the reviewed firm will describe the firm's actions taken or planned to remediate the engagements identified as nonconforming.

In a System Review, a firm's failure to appropriately remediate findings, deficiencies, and nonconforming engagements is a strong indicator of a tone at the top weakness and the team captain should consider whether a related deficiency is appropriate. Reviewers are reminded that firms are only required to remediate as appropriate in accordance with professional standards and are not expected to recall reports or perform additional procedures in every scenario. In general, if firms can articulate their consideration of the professional standards and why the actions taken or planned are deemed appropriate by the team captain, it would not result in a tone at the top deficiency. Firms are discouraged from defaulting to a response of "we'll fix it on the next engagement" without thought behind that response. It may be the appropriate response but firms should be able to articulate why that is the appropriate response.

If after consideration of the firm's response, the team captain determines that there are other systemic issues such as tone at the top, he or she should not avoid addressing the issues, even if it puts the reviewer in an adversarial position. The team captain may consult with the administering entity or AICPA for support in how the issues should be addressed.

## CASE # 9

### System Reviews – Documentation Related to Non-Attest Services

Consider each scenario separately related to System Reviews. It is assumed that each question is separate from the previous or following question within the scenario, unless otherwise indicated.

**Estimated Time to Complete:** 10 Minutes

#### *SCENARIO A*

Team Captain A is performing the peer review of Firm A, a system review with a year-end of 12/31/2017. The only audit engagements performed by Firm A are for manufacturing clients and are performed in accordance with the Statements on Auditing Standards (SASs).

When reviewing the firm's audit engagements, Team Captain A began to question the amount of documentation Firm A was including related to the performance of non-attest services for those audit clients.

Team Captain A notes that for non-attest services, the firm does not document the skills, knowledge or experience of the member of management who will oversee the service. Team Captain A creates an MFC form describing this situation.

#### *QUESTION 1*

Is the MFC form created by Team Captain A appropriate in this situation?

#### *SOLUTION 1*

**There is no explicit requirement in the Code of Conduct that an auditor document the skills, knowledge or experience of the individual from the client overseeing the non-attest service. Therefore, an MFC form may not be necessary in this circumstance. Reviewers should not be confused with requirements for engagements performed in accordance with Government Auditing Standards which has more explicit documentation requirements for the assessment of the relevant skills, knowledge or experience.**

Documentation requirements for auditors who provide non-attest services during the period covered by the financial statements are found in ET sec. 1.295.050. In summary, for non-audit services, an auditor is required to:

- Document the objectives of the engagement, services to be performed, the client's acceptance of its responsibilities, the auditor's responsibilities and limitations on the engagement.
- Have documentation that shows the requirements of ET sec. 1.295.040 were met prior to the period of professional engagement (i.e. before the attest engagement began).

- Note that the Code of Conduct does not specify the form nor the extent of this documentation but auditors should consider ensuring that this documentation complies with AU-C section 230. Auditors should also consider whether the firm appropriately completed the firm's adopted practice aids in compliance with the firm's system of quality control. A departure from a firm's system of quality control that is not a direct departure from professional standards, should generally not be elevated beyond a matter for peer review purposes.

Documenting the skills, knowledge or experience of the individual overseeing the service may be considered best practice, and the [Nonattest Service Toolkit](#) (available on the AICPA website), provides the auditor an opportunity to document the skills, knowledge or experience of individual identified. The checklist included in the toolkit can aid members with evaluating whether independence would be impaired under the interpretations of the "Nonattest Services" subtopic of the "Independence" topic.

### ***QUESTION 2***

Assume that Team Captain A instead finds that firm A has no documentation related to the non-attest service included in the audit file.

Would an MFC form be warranted in this scenario?

### ***SOLUTION 2***

**It is likely that at least an MFC form would be warranted in this scenario as the firm has not complied with any of the documentation requirements for non-attest services. Based on the facts and circumstances of these non-attest services and other non-attest services performed by the firm, Team Captain A would need to determine whether any FFC forms or deficiencies/significant deficiencies are necessary.**

In this situation, the firm has not complied with the documentation requirements related to non-attest services as described in the Code of Conduct. Again, for non-audit services, an auditor is required to:

- Document the objectives of the engagement, services to be performed, the client's acceptance of its responsibilities, the auditor's responsibilities and limitations on the engagement.
- Have documentation that, for nonattest services performed during the period covered by the financial statements, shows the requirements of ET sec. 1.295.040 were met prior to the period of professional engagement (i.e. before the attest engagement began).
  - Note that the Code of Conduct does not specify the form nor the extent of this documentation but auditors should consider ensuring that this documentation complies with AU-C section 230. Auditors should also consider whether the firm appropriately completed the firm's adopted practice aids in compliance with the firm's system of quality control. A departure from a firm's system of quality control that is not a direct

departure from professional standards, should generally not be elevated beyond a matter for peer review purposes.

Discussion leaders may want to discuss with table participants how they would assess partial conformity with the documentation requirements.

### ***QUESTION 3***

If Firm A fails to comply with the documentation requirements as outlined in the Code of Conduct related to the performance of non-attest services, during the period covered by the financial statements, for an engagement, should Team Captain A conclude that the engagement is non-conforming?

### ***SOLUTION 3***

**There is no explicit requirement within the Peer Review Standards and related guidance that states an audit engagement should be considered non-conforming if the firm failed to meet the documentation requirements for non-attest services as outlined in the Code of Conduct. However, it may be appropriate depending on the facts and circumstances of the situation.**

According to PRP Manual Section 3100, “if a firm fails to meet the documentation requirements of ‘Documentation Requirements When Providing Nonattest Services’ interpretation (AICPA Professional Standards, ET sec. 1.295.050), under the “Independence Rule” (AICPA, Professional Standards, ET sec. 1.200.001), that alone does not cause an impairment of independence and therefore does not automatically result in the engagement being deemed as not performed or reported on in conformity with applicable professional standards in all material respects, provided the firm did establish the understanding with the attest client called for in paragraph .01c of the "General Requirements for Performing Nonattest Services" interpretation (AICPA, Professional Standards, ET sec. 1.295.040).

When a firm fails to meet any of the other requirements of the interpretations of the “Nonattest Services” subtopic (AICPA, Professional Standards, ET sec. 1.295), independence has been impaired and the engagement would be deemed as not being performed or reported on in conformity with applicable professional standards in all material respects.”

In addition to complying with the documentation requirements as outlined in the Code of Conduct (ET sec. 1.295.050), reviewers are reminded that firms should comply with AU-C section 230, Audit Documentation, when performing an audit engagement performed in accordance with the Statements on Auditing Standards.

As Standards paragraph .66 states, “For each engagement reviewed, the review team should conclude on its review by documenting whether anything came to its attention that caused it to believe that the engagement was not performed or reported on in conformity with applicable professional standards in all material respects”

Professional judgment is key when concluding on whether an engagement is non-conforming, and failure to properly document key audit procedures oftentimes can lead a reviewer to conclude that an engagement is non-conforming. However, there is not enough information presented in this scenario to come to a definitive solution.

## CASE # 10

### System Reviews – Pre-Issuance Reviews and Internal Inspections

Consider each scenario separately related to System Reviews. It is assumed that each question is separate from the previous or following question within the scenario, unless otherwise indicated.

**Estimated Time to Complete:** 20 Minutes

#### *SCENARIO A*

Jolly Rancher is the Team Captain on the peer review of Mars LLP (the firm), a firm with two partners and five professional staff. The year-end of the peer review was 12/31/2016. The firm's engagement statistics for this year are as follows:

	Engagements performed	Engagements selected
Yellow Book	5	2
Defined Contribution	4	1
Other Audits	15	2
Reviews	10	1
Compilations*	20	1

\*- all compilations were without disclosure.

During his review, Mr. Rancher identified issues related to the partner involvement on all of the audits selected. This resulted in four out of five of the audits selected being deemed not in compliance with professional standards in all material respects. Mr. Rancher issued a fail report. In its LOR, the firm indicated that it would hire a third party to perform pre-issuance reviews on all of the firm's audits.

Subsequently, the Report Acceptance Body accepted the report provided that the firm would hire a third party to perform pre-issuance reviews on one Yellow Book engagement, one Defined Contribution plan and one Other Audit.

Since he provided such valuable information during the peer review, the firm asked Mr. Rancher if he would perform the pre-issuance reviews on the three types of engagements specified by the RAB.

#### *QUESTION 1*

Mr. Rancher performed the pre-issuance reviews on subsequent engagements that were performed in 2017. Mr. Rancher noted that the firm had made considerable improvement and the RAB accepted the corrective actions with no additional follow-up. Provided that Mr. Rancher performed no additional work for the firm, would he be able to perform the firm's next peer review, which is for the year-ended 12/31/2019?

### ***SOLUTION 1***

**Yes, Mr. Rancher would be able to perform the peer review of Mars LLP since there is a cooling off period.**

#### **Interpretation 21-4**

*Question*—Firm A is engaged to perform the peer review of Firm B. However, Firm A performed a pre-issuance review on one of Firm B’s reports and accompanying financial statements for an accounting or auditing engagement during the period since the last peer review year-end. Can Firm A perform the peer review of Firm B?

*Interpretation*—Yes, unless the pre-issuance review(s) was performed on an engagement within the year immediately preceding or during the peer review year.

### ***QUESTION 2***

Standards paragraph .31c states reviewers should, “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 for its most recent System or Engagement Review that was accepted timely, ordinarily within the last three years and six months (see interpretations).”

During scheduling of the 2019 peer review, Mr. Rancher and Mars LLP determined that there were too many scheduling conflicts and the firm would need to find a different peer reviewer. The firm hired Andes Mint to perform the review. Mr. Mint identified issues that were similar to the prior peer review and issued a fail report.

As a result, would Mr. Rancher become ineligible to perform peer reviews based on the requirement outlined in Standards paragraph .31c?

### ***SOLUTION 2***

**No, in this situation Mr. Rancher should not be considered “associated” with Mars LLP. According to Interpretation 21-4, Mr. Rancher could have performed the peer review and was considered to be independent. Standards par .31C was originally written because we were finding individuals that were owners (sometimes employees) of multiple CPA firms. This usually occurred when a firm decided to split itself into two firm, one for the attest practice and the other for its compilation practice. The PRB determined that a peer reviewer “associated” with multiple firms in this manner should receive a pass report on both of its firm’s peer reviews.**

**Although the PRB may explore issuing additional guidance, .31C was not written to “associate” a peer reviewer with reviewed firm simply because it performed the peer review or a corrective action the year immediately following the peer review (assuming the firm was on a 3 –year peer review cycle.**

### ***SCENARIO B***

Now assume, that instead of pre-issuance reviews, the RAB required the firm to hire a third party to perform the firm’s internal inspection and submit a report summarizing the results.

### ***QUESTION 1***

Would Mr. Rancher be able to perform the firm's next peer review, which is for the year-ended 12/31/2019?

### ***SOLUTION 1***

**Yes, similar to scenario A, question 1, Mr. Rancher would be able to perform the peer review of Mars LLP since there is a cooling off period.**

### **Interpretation 21-2**

*Question*—Can an individual from Firm A be engaged by Firm B to conduct monitoring of Firm B's accounting and auditing practice or a consulting review and then be engaged to perform Firm B's subsequent peer review? What about another individual from Firm A?

*Interpretation*—In both cases, yes, except if the monitoring of Firm B's accounting and auditing practice or consulting review is performed for the year immediately preceding or during the peer review year.

### ***QUESTION 2***

Would the fact Mr. Rancher performed the internal inspection for the year ended 2017 cause Mr. Rancher to be associated with the review and would, therefore, not be qualified to perform peer reviews?

### ***SOLUTION 2***

**No, similar to scenario A, question 2, Mr. Rancher would not be considered "associated" with Mars LLP. because Mr. Rancher did not perform any services identified in Interpretation 21-2 for Mars LLP during the peer review year or the year prior. According to Interpretation 21-2, Mr. Rancher would be independent.**

### ***SCENARIO C***

Jolly Rancher was the Team Captain on the peer review of Mars LLP, a firm with two partners and five professional staff for the year-end 12/31/2016. The firm appreciated the valuable information Mr. Rancher provided the firm, so they hired him to perform pre-issuance reviews on all audits performed and the internal inspection for the firm starting in 2017.

The firm received a pass with deficiencies on the peer review for the year-ended 12/31/2019. Andes Mint was the team captain on this review. The issues Mr. Mint identified were related to engagement performance in the engagements subject to Yellow Book and audits of employee benefit plans, both of which led to nonconforming engagements.

Even though Mr. Rancher performs the pre-issuance reviews and internal inspection for Mars LLP, he is a partner at the firm of Hershey and Lindt, LLP (H&L LLP). H&L LLP received a pass with no FFCs on their most recent peer review.

***QUESTION 1***

The term “associated” as used in paragraph .31c (see above) is not defined within the peer review program manual.

Discuss within your group the following:

- a. Whether you believe this is a significant issue.
- b. Factors that should be considered by a reviewer and their administering entity in determining when a reviewer should be considered “associated” with a firm. For example, in the scenario above, would Mr. Rancher be considered “associated” with Mars LLP?
- c. Should the administering entity or RABs be able to decide on whether a third party is associated with a firm?

Based on this and other feedback, the Standards Task Force of the Peer Review Board may seek to provide more guidance as they clarify Peer Review Program guidance.

## CASE # 11

### System Reviews – Must-Select Engagements

Consider each scenario separately related to System Reviews. It is assumed that each question is separate from the previous or following question within the scenario, unless otherwise indicated.

**Estimated Time to Complete:** 15 Minutes

#### **BACKGROUND INFORMATION**

Paragraph .59 of the Peer Review Standards state the following:

*“Engagements selected for review should provide a reasonable cross section of the reviewed firm’s accounting and auditing practice, with greater emphasis on those engagements in the practice with higher assessed levels of peer review risk.”*

To assist the peer reviewer in addressing this requirement, the following question is included in the Summary Review Memorandum (Question I):

*“Based on your responses to the previous questions, describe your planned selection of office(s) and engagement(s) for review to reduce peer review detection risk to an acceptably low level. Include how the scope covered a reasonable cross-section of the reviewed firm’s accounting and auditing practice, with greater emphasis on those engagements in the practice with a higher assessed level of peer review risk.”*

#### **SCENARIO A**

The accounting firm of Chubb & Chubb, LLP consists of two partners that perform A&A work, Bradley Chubb and Nick Chubb. The engagement listing provided to Chubb & Chubb’s peer reviewer reflected the following information pertaining to ERISA engagements:

	Hours	# of Engagements
Defined Contribution Plans (excluding 403(b) plans)	1,266	10
Defined Benefit Plans	1,025	7
ERISA Health & Welfare Plans	1,192	10

The peer reviewer selected two Defined Contribution Plans and one Health & Welfare Plan. In response to Question I on the Summary Review Memorandum, he wrote:

*“The firm only has one office. Engagements were selected to satisfy the must select engagement requirements, the audits of higher risk, then to obtain a cross section of industries and engagement partner.”*

#### **QUESTION 1**

How could the peer reviewer’s response to Question I be rewritten to properly address the requirements of Paragraph .59 of the Peer Review Standards?

### ***SOLUTION 1***

**Note: There is no single correct response to this question. Allow participants to discuss elements that should be included in the peer reviewer's response.**

**For reference, Interpretation 59-1 includes the following as it relates to ERISA engagements; ensure each of these items are mentioned in the discussion.**

*“For employee benefit plans under ERISA, the peer reviewer should consider whether the engagement selection process has adequately addressed the risks involved in limited versus full scope audits and in different types of benefit plans such as defined benefit, defined contribution, and voluntary health and welfare plans. 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 risk assessment. Peer reviewers should also consider audit firm experience such as how many ERISA audits the firm performs, the length of experience in performing these engagements, the number of team members with experience, whether the team members have undergone CPE or specialized training, and reasonableness of hours spent on ERISA engagements. Further consideration should be given to communications from regulatory agencies.”*

### ***QUESTION 2***

What are some unique risks associated with the firm's population of EBP engagements, and what considerations should the reviewer have documented when deciding to select two Defined Contribution Plans and one Health & Welfare Plan?

### ***SOLUTION 2***

**Note: There is no single correct response to this question. Allow participants to discuss elements that should be included in the question's response.**

**At a minimum, the reviewer's documentation should explain his rationale for not selecting a Defined Benefit Plan. The following are unique risks associated with each type of ERISA engagement:**

- **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 by not reported, postemployment benefits, postretirement health care benefits, etc.)**

**Interpretation 59-1 also states:**

*“The reviewer should explain and document in the Summary Review Memorandum key decisions that he or she made when he or she chose not to select any one or more of the following: a level of service, industries in which a significant public interest exists, and industries in which the firm performs a significant number of engagements. This does not give authority to the reviewer to avoid selecting an engagement(s) by simply documenting the reason(s) why he or she did not select certain engagement(s). Therefore the reviewer should document important considerations regarding the engagement selection process.”*

## **SCENARIO B**

The accounting firm of Chubb & Chubb, LLP consists of two partners that perform A&A work, Bradley Chubb and Nick Chubb. The engagement listing provided to Chubb & Chubb's peer reviewer reflected the following information pertaining to engagements subject to *Government Auditing Standards*:

	Hours	# of Engagements
Single Audit Engagements	1,270	3
All others subject to GAS	825	2

### **QUESTION 1**

Per discussion with Bradley Chubb, the "All others subject to GAS" engagements are not subject to the Single Audit Act.

If the peer reviewer selected one of the "All others subject to GAS" engagements, would this suffice as appropriate must-select engagement selection?

### **SOLUTION 1**

**No; refer to guidance below.**

**Interpretation 63-1a includes the following as it relates to GAS engagements:**

*Additionally, if the engagement selected is of an entity subject to GAS but not subject to the Single Audit Act and the firm performs engagements of entities subject to the Single Audit Act, at least one such engagement should also be selected for review. The review of this additional engagement must evaluate the compliance audit requirements and may exclude those audit procedures strictly related to the audit of the financial statements.*

## CASE # 12

### System Reviews – Findings, Deficiencies and Significant Deficiencies

Consider each scenario separately related to System Reviews. It is assumed that each question is separate from the previous or following question within the scenario, unless otherwise indicated.

**Estimated Time to Complete:** 20 Minutes

#### SCENARIO A

Review the following excerpt of an FFC:

REVIEWER'S DESCRIPTION OF THE FINDING (The description of the finding should include the applicable requirement of Statements on Quality Control Standards, the scenario that led to the finding, and should reference nonconforming engagements as a result of the finding, if applicable.)
The firm's risk assessment was set at less than high without documentation of the firm's evaluation.
SYSTEMIC CAUSE OF FINDING
Lack of documentation
REVIEWED FIRM'S RESPONSE TO THE REVIEWER'S FINDING(S) DESCRIBED ABOVE
The response should describe the following:
<ul style="list-style-type: none"><li>The firm's actions taken or planned to remediate findings in the firm's system of quality control (see <a href="#">interpretations</a>)</li></ul>
Going forward, the firm will document its evaluation of risk at the assertion level to support the overall risk assessment
For nonconforming engagements, the response should also describe the following:
<ul style="list-style-type: none"><li>The firm's actions taken or planned to remediate the engagements identified on the FFC form as nonconforming</li></ul>
N/A
Timing of the remediation
Immediately

### ***QUESTION 1***

Does the reviewer's description of the finding and systemic cause from the preceding example FFC meet peer review requirements?

#### ***SOLUTION 1***

**The Reviewer's Description of the Finding does not meet the relevant peer review requirements because the team captain did not reference the applicable requirement of the Statement on Quality Control Standards (SQCS).**

**The systemic cause also does not meet the relevant peer review requirements because it does not address the weakness in the firm's system of quality control that allowed the matter to occur or remain undetected. In this example, the firm describes the symptom (there was a lack of documentation related to the firm's risk assessment), but it does not describe why documentation was lacking.**

If the TC had identified the applicable requirement of the SQCS in the description, it may have been easier to identify the systemic cause. The definition of "systemic cause" is provided in PRP Section 1000 paragraph .75;

"The team captain, in collaboration with the firm, should determine the systemic cause of matters identified. A systemic cause is a weakness in the firm's system of quality control that allowed a matter to occur or remain undetected. Proper determination of the systemic cause is essential to assist the firm with identifying the appropriate remediation of the firm's system of quality control."

### ***QUESTION 2***

Does the firm's response from the preceding example FFC meet peer review requirements?

#### ***SOLUTION 2***

**No, because it does not include specific actions that the firm has taken or planned to remediate the findings and deficiencies in the firm's system of quality control. In this situation, it may be difficult for the firm to identify the proper remediation because the systemic cause of the matter has not been identified.**

The firm's required response is described in PRP section 1000 paragraph 99.

If the reviewed firm receives an FFC form or a report with a peer review rating of pass with deficiencies or fail, it is the firm's responsibility to identify the appropriate remediation of any findings, deficiencies, and significant deficiencies and to appropriately respond. The reviewed firm should address the following in its response with respect to each finding, deficiency, and significant deficiency (see interpretations):

- a. Nonconforming engagements, including the following:
  - i. The firm's actions taken or planned to remediate the engagements identified on the FFC form or in the report as nonconforming.

- ii. The firm's actions taken or planned to remediate findings and deficiencies in the firm's system of quality control (see interpretations)
- b. Systemic issues unrelated to nonconforming engagements:
  - i. The firm's actions taken or planned to remediate findings and deficiencies in the firm's system of quality control
- c. Timing of the remediation

Additionally, PRP Section 4960 paragraph .06 states;

It is the firm's responsibility to identify the appropriate remediation of any findings, deficiencies, and significant deficiencies and to appropriately respond. However, the AICPA Peer Review Board encourages the reviewed firm to work with the team captain to develop remedial actions that both parties believe will be effective in correcting the matters, findings, and deficiencies noted during the peer review. Experience shows that improvement is more likely to occur when the remediation describes specific actions to be taken. Therefore, **a response limited to the firm's comment that it will emphasize or reemphasize a policy or procedure should be combined with more specific actions.**

This example demonstrates the importance of properly identifying the systemic cause. Without a proper systemic cause, the firm is unable to identify specific actions they can take to keep the matter from occurring again in the future. Without these actions, the firm is liable to keep making the same mistake, increasing the odds it is found again in future peer reviews. If the mistake is significant enough, it increases the odds that a firm will receive consecutive non-pass peer review report ratings, which may have a significant impact on the firm's A&A practice.

### **QUESTION 3**

How could the example FFC in Scenario A be rewritten to comply with peer review requirements?

### **SOLUTION 3**

This question is designed to generate discussion among participants. There is no one correct answer. The following is an example of how the language in the FFC could be improved.

<p>REVIEWER'S DESCRIPTION OF THE FINDING (The description of the finding should include the applicable requirement of Statements on Quality Control Standards, the scenario that led to the finding, and should reference nonconforming engagements as a result of the finding, if applicable.)</p>
<p>The firm did not comply with its QC policies related to engagement performance. The supervising partner did not properly review the engagement work papers to ensure adequate documentation existed for the firm's risk assessment. The firm's risk assessment was set at less than high with a checkmark next to low without documentation of the firm's evaluation. Other engagements reviewed provided sufficient documentation of the firm's evaluation.</p>
<p>SYSTEMIC CAUSE OF FINDING</p>

The supervising partner review was not in compliance with the firm's system of quality control, such that insufficient documentation was not remediated prior to the conclusion of the engagement.
REVIEWED FIRM'S RESPONSE TO THE REVIEWER'S FINDING(S) DESCRIBED ABOVE
The response should describe the following:
<ul style="list-style-type: none"> <li>The firm's actions taken or planned to remediate findings in the firm's system of quality control (see <a href="#">interpretations</a>)</li> </ul>
The firm's QC Partner will hold a firm training on documentation with emphasis placed on complying with risk assessment guidance. After the peer review, the QC Partner will review the findings with all Partners/Managers responsible for supervising auditing and accounting services. The QC Partner will perform random checks on engagements to look for a thorough supervising partner review of risk assessment documentation. Additionally, the firm's monitoring procedures will be updated to include a review of risk assessment on engagements selected during the firm's inspection process.
For nonconforming engagements, the response should also describe the following:
<ul style="list-style-type: none"> <li>The firm's actions taken or planned to remediate the engagements identified on the FFC form as nonconforming</li> </ul>
Timing of the remediation
The staff training is scheduled for April 2018. The peer review recap with Partners occurred Feb 1, 2018. QC Partner checks will be performed throughout 2018, beginning in April.

See preceding solutions for applicable guidance.

### **SCENARIO B**

The peer review report for a System Review included the following deficiency:

1. The firm's quality control policies and procedures related to engagement performance require that engagements comply with applicable audit standards. This includes the selection of an adequate sample size in testing internal controls and compliance with Federal award programs under Government Auditing Standards. The firm selected an inadequate sample size in evaluating the testing of controls and compliance.

The firm's Letter of Response included the following:

1. The firm will review professional standards and adjust sampling procedures to ensure an adequate sample size in compliance with applicable professional standards.

## ***QUESTION 1***

How could the preceding deficiency be changed to meet peer review standards?

### ***SOLUTION 1***

**The preceding deficiency does not describe the scenario that led to the deficiency or the systemic cause. Some areas for the team captain to consider, in collaboration with the firm, include, but are not limited to:**

- Was the engagement supervised appropriately?
- Did the staff have adequate training?
- Should the firm's monitoring procedures have identified the deficiency?
- Was there an EQCR? If not, should there have been or is there EQCR policy adequate?
- Did the firm comply with their acceptance and continuance policies? If so, are they appropriate?

It could be rewritten as follows:

1. The firm's quality control policies and procedures related to engagement performance require that the firm's audit engagements comply with applicable audit standards. Additionally, the firm's human resource policies indicate that each engagement team should be composed of individuals with the requisite experience or training to perform the engagement. The review team noted the senior manager on an engagement performed under Government Auditing Standards did not have experience nor CPE in this practice area; the other individuals on the team were in compliance with CPE requirements. In our opinion, this led to the firm selecting an inadequate sample size in evaluating the testing of controls and compliance with Federal award programs under Government Auditing Standards.

PRP section 1000 paragraph .96p(i). states;

Include descriptions of the deficiencies or significant deficiencies (each of these should be numbered) which include reference to the applicable requirement of Statements on Quality Control Standards, **the scenario that led to the deficiency or significant deficiency**, and reference to nonconforming engagements as a result of the deficiency or significant deficiency, if applicable (see interpretations).

Additionally, PRP section 4250 paragraph .02 states;

On a System Review, the deficiencies in the report should be written with a systemic orientation and include

- a. what the firm's policies and procedures include or exclude (what the system is designed to do or not designed to do), and the particular reference to the applicable requirement of Statements on Quality Control Standards. The deficiency in the report articulates that the firm's system of quality

control is not designed in accordance with professional standards or if designed appropriately, the firm's failure to comply with or document its compliance with an appropriately designed system.

**b. the systemic cause of the deficiency. What happened (design failure or pervasive compliance issues) that caused the deficiency?** This is often the most difficult area to identify when writing a deficiency, and should be determined in collaboration with the firm. It is extremely important to identify the systemic cause and not just the firm's failure to comply with professional standards in all material respects. This is ultimately what the firm will need to change (the design of its system of quality control or how the firm complies with an appropriately designed system) in order for the deficiency not to recur.

## ***QUESTION 2***

Using the example provided in Solution 1, how could the preceding firm response be changed to meet peer review standards?

### ***SOLUTION 2***

The firm should address specific actions to address what went wrong with their system of quality control, identify the responsible party, and establish the timing of the remediation.

1. We further investigated the scenario that led to the deficiency and noted the manager originally assigned to the engagement, whom had the requisite experience, was delayed on a different engagement. The partner assigned to the engagement did not verify the replacement manager's experience. The partner in charge did have the requisite CPE, but during review did not find the error in sample size. The planning procedures documented an appropriate sample size, but the senior manager that performed the testing did not consult the planning documentation. The QC Partner's review will now include a review of the experience/CPE of any senior personnel that are assigned on industry specific engagements after planning has already taken place.

Refer to the guidance referenced in Scenario A Solution 2.