

Reviewer alert

October 2018

This Reviewer Alert contains the following articles:

- [Revisions Made to September Reviewer Alert Article *New Guidance on the Evaluation of Non-compliance with the Risk Assessment Standards and its Impact to the Peer Review*](#)
- [Enhanced Oversight Risk Assessment Documentation Focus](#)
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Revisions Made to September Reviewer Alert Article *New Guidance on the Evaluation of Non-compliance with the Risk Assessment Standards and its Impact to the Peer Review*

In the September 2018 Reviewer Alert, the article *New Guidance on the Evaluation of Non-compliance with the Risk Assessment Standards and its Impact to the Peer Review* was published to alert reviewers to the recently issued guidance in PRPM 3100. Additionally, the article provided detailed examples of non-compliance with the Risk Assessment Standards, discussed the peer review impact of non-compliance and instructed RABs on implementation. Based on feedback received, the following clarifications were made to the article.

- Under the Reviewer Evaluation of Engagements heading, *failure to gain an understanding of internal control when identifying client's risks* section, language was added to the last three bullets to clarify they are examples of non-compliance.
- Under the Reviewer Evaluation of Engagements heading, *insufficient risk assessment* section, additional guidance was included in the second bullet to clarify the presumption of a significant risk.
- Under the Other Important Information heading, *reviewer performance* section, language was added to clarify that there is not a presumption that every peer review should indicate non-compliance with the Risk Assessment Standards.

To see the previous article in track changes, [click here](#). In addition, a clean version of the article has been posted to the [AICPA website](#).

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Enhanced Oversight Risk Assessment Documentation Focus

To help educate peer reviewers and firms, and to provide feedback to the Peer Review Board (PRB), the Enhanced Oversight process has been updated to focus on risk assessment documentation. Subject Matter Experts (SMEs) will now review the risk assessment

documentation for the non-Single Audit portion of the Single Audit engagements selected for oversight. Previously, the SMEs only reviewed the Single Audit portion of the audit. For all other engagements selected for oversight, the process will be the same, with the new focus on the risk assessment documentation.

Based on the oversight findings, the PRB may provide additional guidance or update the peer review checklists. As a reminder, for reviews commencing December 31, 2018 or earlier, peer reviewers will receive a reviewer performance finding (as opposed to a potential reviewer performance deficiency) if the reviewer fails to properly identify issues involving non-compliance with the Risk Assessment Standards or fails to properly assess non-compliance with the Risk Assessment Standards in the context of a peer review.

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Do your peer review clients use PPC checklists?

Earlier this month, PPC issued a special report to its customers, focusing on the Risk Assessment Standards. The complimentary report addresses several topics, including:

- PRB concerns,
- PPC methodology,
- How auditors may be misusing PPC forms in certain situations and
- What to expect in your next peer review.

We encourage you to share the report with your peer review clients that use PPC checklists to underscore the importance of properly assessing risk and linking that assessment to audit procedures. For details, see the email below.

You may also want to point your clients to the AICPA's Risk Assessment Toolkit, featuring a myriad of free resources such as an audit guide, templates, an internal inspection aid, FAQs and more at aicpa.org/riskassessment.



PPC ACCOUNTING AND AUDITING UPDATE—SPECIAL REPORT

Dear PPC Customer,

Although the auditing standards related to risk assessment have not recently changed, peer reviewers have been noting deficiencies in that area in a relatively high percentage of audits. As a result, beginning October 1, 2018, the AICPA Peer Review Board (PRB) will be requiring peer reviewers to consider otherwise compliant audit engagements with risk assessment

problems to be nonconforming engagements with potentially significant peer review implications.

We are providing you with this complimentary **PPC Accounting and Auditing Update - Special Report** to share with you the PRB's concerns; revisit the risk assessment standards; discuss the PPC methodology and how auditors may be misusing our forms in certain situations; and help you gain an understanding of what to expect in your next peer review.

Thank you for your business, and we look forward to continuing to serve you.

Sincerely,

Colleen Bellers
Product Manager, Audit & Accounting Segment

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REVISED ARTICLE FROM SEPTEMBER ALERT: New Guidance on the Evaluation of Non-compliance with the Risk Assessment Standards and its Impact to the Peer Review

Attendees at 2018 Peer Review Conference – see note at end of this article.

The Peer Review Board approved a new section to PRPM 3100 entitled, "Evaluation of Non-compliance with the Risk Assessment Standards," effective for reviews commencing on or after October 1, 2018 through reviews commencing on or before September 30, 2021. Early implementation is permitted at the peer reviewer's discretion.

The guidance:

- Provides considerations for the reviewer to use when evaluating the reviewed firm's compliance with the Risk Assessment Standards contained in AU-C secs. 315 and 330
- Defines the peer review impact when non-compliance is identified with those standards and
- Instructs RABs to require certain implementation plans or corrective actions when Findings for Further Consideration forms or deficiencies in the peer review report are issued

Reviewer Evaluation of Engagements

When evaluating a firm's compliance with the Risk Assessment Standards, as a reviewer, you should be aware of the following areas of common non-compliance.

Failure to gain an understanding of internal control when identifying client's risks

- Auditors are expected to perform the following steps when gaining an understanding of internal control; an audit omitting one or more of these steps results in non-compliance
 - Consider what could go wrong as the client prepares its financial statements
 - Identify the controls intended to mitigate those financial reporting risks
 - Evaluate the likelihood that the controls are capable of effectively preventing or detecting and correcting material misstatements-
- Some auditors may inappropriately indicate that the requirements of AU-C 315.14 do not apply to their client because their client has no controls. **This is a false assumption**
- Auditors may erroneously default to control risk at the maximum level without gaining an understanding of the client's internal control. This is not permitted under the current Risk Assessment Standards, even when not intending to rely on tests of controls
- Auditors may inappropriately reduce control risk to less than high without appropriately testing relevant controls.

Insufficient risk assessment

- Regardless of the nature and extent of substantive procedures, performing the audit in accordance with GAAS includes the following requirements for each engagement; omitting one or more of these requirements results in non-compliance
 - Identify the client's risks of material misstatement (RMM) by gaining an understanding of the client and its internal control (Identify RMM)
 - Assess the risks (Assess RMM) and
 - Design or select procedures that respond to those risks (Respond to RMM)
- Regardless of the size of the entity, Failure to identify at least one significant risk almost always represents a failure to comply with AU-C 315.28. -AU-C 240.26 states, there is a presumption that risks of fraud exist in revenue recognition, and under AU-C 240.27 states, risks of material misstatement due to fraud should be treated as significant risks.
- Failure to assess risk of material misstatement at **both** the financial statement level¹ **and** relevant assertion-level² for significant classes of transactions, account balances or disclosures represents non-compliance with AU-C 315.26.
- Some auditors are documenting RMM at the audit area level for every audit area, citing the risk assessment is the same for all assertions, when not all assertions are relevant

Failure to link procedures performed to the risk assessment

- Audit procedures should be responsive to the client's financial statement- and relevant assertion-level risks for significant classes of transactions, account balances or disclosures. The linkage is at the assertion (not account) level
- Some auditors are performing the risk assessment in accordance with AU-C 315 but designing the audit procedures with little regard for the results of that assessment. If the

¹ meaning to assess risks which are pervasive to the financial statements, like a lack of expertise in the accounting department

² meaning to assess risk for assertions that have a reasonable possibility of material misstatement, not every assertion for every account

risks are not properly reduced to an acceptably low level, the auditor hasn't complied with the standards

As a reviewer, you should be mindful that your objective is to determine whether the firm met the requirements outlined in the Risk Assessment Standards. Your objective is not necessarily to determine that all the engagements' forms and practice aids were completed correctly. Even if certain practice aids are not completed correctly, firms may be able to evidence compliance with the requirements through other means. If the workpapers lead you to suspect a lack of understanding of the Risk Assessment Standards exists, you should have thorough conversations with your peer review clients to determine if they met all the requirements, including documentation.

Peer Review Impact

If you find non-compliance with the Risk Assessment Standards, the engagement should be deemed non-conforming. The impact on the peer review is illustrated in the following chart.

If the non-compliance is not considered isolated, you should issue:

- A finding if no deficiencies or significant deficiencies related to other engagement performance issues are noted, even if **all** the engagements reviewed are non-conforming solely due to non-compliance with the Risk Assessment Standards
- A deficiency or significant deficiency if deficiencies and significant deficiencies related to other omitted audit procedures exist
- A finding if there are deficiencies or significant deficiencies related to elements of a firm's system of quality control that did not result in omitted audit procedures (for example; monitoring or tone at the top)

Non-compliance noted	Isolated or Systemic	Conclusion
Failure to comply with the Risk Assessment Standards	Isolated	MFC
Failure to comply with the Risk Assessment Standards	Systemic	FFC and Implementation Plan
Failure to comply with the Risk Assessment Standards and other deficiencies or significant deficiencies exist that resulted in omitted audit procedures	Systemic	Deficiency or Significant Deficiency with Corrective Action

Required Firm Remediations

When an FFC is required for non-compliance with the Risk Assessment Standards, the RAB should require an implementation plan that includes one or more of the following:

- CPE (webcast, other)
- Pre-issuance reviews
- Post-issuance reviews

As a reviewer, you should provide recommendations to the RAB regarding the type of follow-up action you believe is appropriate in the circumstances. The type of follow-up action that is required should be entirely dependent on the nature and extent of the non-compliance you

identify. For example, CPE might be appropriate if certain requirements were performed but not documented. However, for more significant instances of non-compliance, for example when the firm fails to identify any significant risks and significant risks are present, you should suggest more substantial follow-up actions, such as pre- or post-issuance reviews.

The firm is expected to comply with all requirements of the Program, including remediation of non-conforming engagements.

Other Important Information

PRIMA

Changes will be made within PRIMA to allow you to indicate the number of non-conforming engagements due to non-compliance with the Risk Assessment Standards. This will provide a mechanism for Staff to track the effectiveness of the initiative. These changes are expected to be implemented in early 2019. Once finalized, Staff will communicate the nature of the changes and provide any necessary instructions to you and other relevant stakeholders. Until the changes are made, you should continue the current process to identify and document non-conforming engagements in PRIMA.

Reviewer Performance

For reviews commencing December 31, 2018 or earlier, if issues involving non-compliance with the Risk Assessment Standards exist, and the reviewer fails to properly identify the non-compliance or fails to properly assess non-compliance with the Risk Assessment Standards in the context of a peer review, the result you will be receive a reviewer performance finding (as opposed to a potential reviewer performance deficiency) ~~if you fail to properly identify issues involving non-compliance with the Risk Assessment Standards or fail to properly assess non-compliance with the risk assessment standard in the context of a peer review.~~ Failure to properly assess non-compliance with the Risk Assessment Standards could include failure to conclude the engagement is non-conforming or failure to issue a finding, deficiency or significant deficiency when appropriate.

Resources for Risk Assessment

Free webcast with CPE:

- [September 17, 2018 3:30 – 5:30pm ET](#)
- [September 26, 2018 11 am-1pm ET](#)
- [October 4, 2018 2-4 pm ET](#)

Additional free resources available at aicpa.org/riskassessment, including:

- Audit risk assessment tool
- Staff training workshop
- Internal inspection aid and
- Aid for identifying and testing controls at smaller entities

Note to Attendees of 2018 Peer Review Conference

During the Peer Review Update presentation, substantial attention was given to Exhibit CX-7.1 (Risk Assessment Summary Form) used in the methodology developed by Practitioners' Publishing Company (PPC). From some participant comments, a misperception may exist that this is the only form required to be completed with this methodology to evidence compliance with the risk assessment standards. In fact, PPC's methodology includes several exhibits/forms

to use for this purpose. Also, as noted above, evidence of compliance may be achieved by means other than completing forms from practice aids.

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