

Reviewer alert

January 2019

This Reviewer Alert contains the following articles:

- [Yellow Book Independence – Peer Review Perspective](#)
- [Nonconforming Engagement Representation in a Firm's Representation Letter](#)
- [Update on Quality Control Materials \(QCM\) Reports Used in Peer Reviews](#)
- [Peer Review Technical Staff Update](#)

Yellow Book Independence – Peer Review Perspective

This article seeks to reiterate and clarify PRP Section 3100 *Supplemental Guidance* regarding the 2011 *Government Auditing Standards* (GAS also known as the Yellow Book) independence documentation requirements, especially related to threats and safeguards documentation.

The auditor's consideration of independence for nonaudit services should include the required documented elements (GAS par. 3.59):

- 1) understanding with the audited entity regarding the nonaudit service;
- 2) consideration of management's ability to oversee the nonaudit service, including designated individual's skills, knowledge, and experience (SKE);
- 3) identification of threats that require safeguards (significant threats); and
- 4) application of safeguards to eliminate or reduce significant threats to an acceptable level.

Documentation of independence considerations provides evidence of the auditor's judgments in forming conclusions regarding compliance with independence requirements. Historically peer reviewers hesitated to identify and address Yellow Book documentation departures if the reviewed firm was able to otherwise convincingly demonstrate that independence was not impaired. PRP Section 3100 *Supplemental Guidance* and previous Reviewer Alerts have attempted to further emphasize properly recognizing and addressing Yellow Book independence documentation departures. While there has been improvement by reviewers, technical reviewers, and enhanced oversight reviewers in identifying nonconformity with the standards, there are also concerns about incorrect conclusions without considering all of the relevant factors.

PRP section 3100 *Supplemental Guidance* (Implications of the 2011 Yellow Book and Performance of Nonaudit Services Question 4) indicates:

*The peer reviewer is likely to encounter situations where the engagement is somewhere on a continuum of compliance with standards. If there is a **failure to document one or more of the elements** of the independence evaluation required by the 2011 Yellow Book, ordinarily the engagement should be considered as not performed in conformity with applicable professional standards in all material respects. If there is marginal documentation of a particular element required by professional standards, the peer reviewer should use judgment to determine the degree of noncompliance on the conclusion of the engagement.*

Consider the following common scenario:

The engagement documentation identified

- the understanding with the client for a nonaudit service (preparation of the financial statement), and
- management's ability to oversee the nonaudit services, including the SKE of the designated individual responsible for overseeing the nonaudit services.

Based on the evidence (e.g. auditor was materially involved in the financial statement preparation, including notes, and SEFA, and auditor proposed material journal entries, etc.), it appears that significant threats to independence exist. However, the engagement workpapers did not document that the threats were significant, nor explicitly identify which safeguards were applied to reduce such threats to an acceptable level. There is evidence in the workpapers that an EQCR was performed on the engagement in accordance with the firm's quality control policy applicable to all audits.

The reviewer discusses the appearance of the existence of significant threats to independence with the firm and the firm indicates to the reviewer that client SKE and firm EQCR were the safeguards.

In the preceding scenario, the engagement would ordinarily be deemed nonconforming for failure to document identification of a significant threat. Additionally, the reviewer should consider whether the documentation of the safeguard applied was marginal by evaluating evidence such as a completed and signed EQCR checklist that includes proper consideration of threats to independence over nonaudit services within engagement workpapers. Client SKE should not be viewed as safeguard, but rather a mandatory condition before performing any nonaudit services. If documentation of safeguards applied is less than marginal, this departure may also contribute to a nonconforming engagement (in addition to the departure for not identifying and documenting a significant threat).

The Yellow Book (GAS par. 3.16) requires the auditor to address the specific facts and circumstances when applying safeguards. Evidence that a safeguard was implemented is relevant to determine that independence was not impaired, but that alone is not sufficient to meet the documentation requirements of the standard. While EQCR may be a sufficient safeguard in this situation, it should be documented as a safeguard applied to reduce the significant threat. It is not appropriate to presume (without evidence) that the implementation of

EQCR indicates the auditor assessed or concluded that a significant threat existed or that EQCR sufficiently eliminated or reduced all relevant threats to an acceptable level (e.g. self-review, familiarity, management participation, etc. as noted in GAS par. 3.15).

Reviewers are reminded that their objective is not to determine that all the engagements' forms and practice aids were completed correctly. Consider if firms can otherwise demonstrate their compliance with **all** requirements, including documentation, or whether there is a lack of understanding. Reviewers should thoroughly document all relevant considerations within the peer review working papers to reduce challenges during technical review and RAB acceptance.

[Back to Top](#)

Nonconforming Engagement Representation in a Firm's Representation Letter

If a nonconforming engagement has **only** been documented on a Matter for Further Consideration Form, the firm may meet their required representation to remediate nonconforming engagements by including the following paragraph in their firm's representation letter.

We confirm that we will implement the remedial plans for nonconforming engagements stated in our response to the Matter for Further Consideration Form.

In this instance, the technical reviewer or RAB should not ask the firm to provide additional details to their representation regarding remediation of nonconforming engagements.

Peer Review Standards par. .208 requires the firm to include a specific representation acknowledging that the firm will remediate nonconforming engagements, if applicable. The following is the illustrative paragraph provided in the Peer Review Standards.

We confirm that we will implement the remedial plans for nonconforming engagements stated in our response to [insert relevant form, for example 'Finding for Further Consideration Form 1'].

The firm may tailor the language in the illustration if adequate representations are included to the satisfaction of the team captain.

[Back to Top](#)

Update on Quality Control Materials (QCM) Reports Used in Peer Reviews

Quality Control Material (QCM) reviews for the following providers are available on the [QCM Review Results](#) webpage. Several new reviews have been recently posted.

- BDO USA, LLP
- CaseWare International
- CCH Incorporated
- John Wiley & Sons, Inc.'s Advantage Audit
- RSM US, LLP
- Thomson Reuters Practitioner's Publishing Company (PPC)

Some tips for using the [QCM Review Results](#) webpage:

- Check the searchable pdf tool to determine whether and when the *specific* QCM used by the firm you are reviewing has been subject to a QCM review, and the results.
- Do not assume all of the firm's QCM have been included in scope; the provider determines scope. Certain exclusions are mentioned in the report and/or attachments.
- Read the QCM review reports, which reminds the user to “carefully consider the scope of the QCM review, understand the intended uses and limitations of the materials, and the users’ responsibility for evaluating the QCM’s suitability and for implementing, tailoring and augmenting the QCM as appropriate.”

[Back to Top](#)

Peer Review Technical Staff Update

As of January 1, Laurel Gron has been promoted to Senior Manager. She will continue to be responsible for oversight.

Karl Ruben has accepted a senior manager position working on Dynamic Audit Solutions (DAS). DAS is a new project at the Association and is a key strategic initiative for 2019.

Tricia VanVliet has accepted a manager position with Product Management and Development. In her new role, Tricia will take over leadership of the development of AICPA Employee Benefit Plan (EBP) products. This position allows her to focus on EBP, which she has been heavily involved in throughout her career.

Karl and Tricia are slowly transitioning into their new roles, while completing tasks related to oversight. We expect a full transition to be effective February 1.

Many of you have reached out directly to Tricia and Karl with inquiries. Going forward, please send all inquiries for technical staff to prptechnical@aicpa.org.

[Back to Top](#)