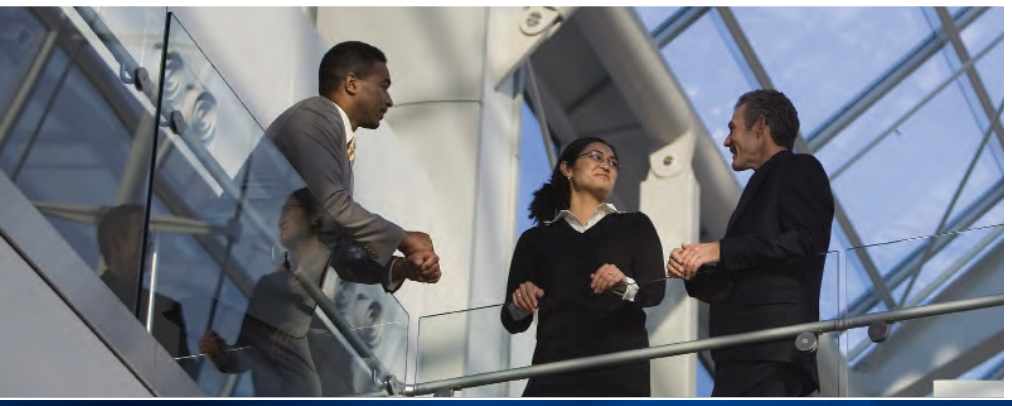
PRACTICE AID SERIES

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



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Notice to Readers

This AICPA Audit and Accounting Practice Aid updates *Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, which was issued in 2007. This practice aid is intended to help practitioners better understand and apply Statement on Quality Control Standards (SQCS) No. 8, *A Firm's System of Quality Control (Redrafted)* (AICPA, *Professional Standards*, QC sec. 10). That standard is included in appendix A of this practice aid. This version of the practice aid, prepared by the Quality Control Standards Task Force, has been revised to incorporate new policies and procedures that a firm should consider including in its system of quality control to be responsive to the issuance of SQCS No. 8. The policies and procedures presented in this practice aid are illustrative, and firms are encouraged to consider them in designing and maintaining a system of quality control that is appropriate for their accounting and auditing practices. Some of the policies and procedures presented in this practice aid are not required by the SQCSs; however, they represent the views of the task force regarding best practices for a quality control system. Although this practice aid has been reviewed by the AICPA Audit and Attest Standards staff, it has not been approved, disapproved, or otherwise acted upon by any senior technical committee of the AICPA and has no official or authoritative status.

The Sarbanes-Oxley Act of 2002 (act) created the PCAOB and charged it with overseeing audits of issuers, [fn 1] as defined by the act. Under the act, the PCAOB's duties include, among other things, establishing auditing, quality control, ethics, independence, and other standards relating to audits of issuers.

This practice aid does not address the quality control requirements of the act, nor does it address the quality control requirements of PCAOB standards that must be followed by auditors of issuers. Auditors of issuers should follow these other standards and make changes to their firm's quality control systems as necessary. Auditors of nonissuers who are engaged to report on audit engagements in accordance with PCAOB auditing standards also must report on those engagements in accordance with generally accepted auditing standards (GAAS). Interpretation No. 17, "Clarification in the Audit Report of the Extent of Testing of Internal Control Over Financial Reporting in Accordance With Generally Accepted Auditing Standards," of AU section 508, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, AU sec. 9508 par. .85–.88), and Interpretation No. 18, "Reference to PCAOB Standards in an Audit Report on a Nonissuer," of AU section 508 (AICPA, *Professional Standards*, AU sec. 9508 par. .89–.92), provide reporting guidance for audits of nonissuers when the auditor is asked to report in accordance with GAAS and PCAOB auditing standards.

Additional information about the PCAOB and the act can be obtained at the PCAOB website at www.pcaobus.org.

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[fn 1] Paragraph 7 of Section 2, "Definitions," of the Sarbanes-Oxley Act of 2002 states, "The term *issuer* means an issuer (as defined in section 3 of the Securities Exchange Act of 1934 [15 U.S.C. 78c]), the securities of which are registered under section 12 of that act [15 U.S.C. 78l], or that is required to file reports under section 15(d) [15 U.S.C. 78o(d)], or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 [15 U.S.C. 77a et seq.], and that it has not withdrawn."

Quality Control Standards Task Force (2011)

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Chapter 1

Overview of Statements on Quality Control Standards

1.01 The objectives of a system of quality control are to provide a CPA firm with reasonable assurance [fn 1] that the firm and its personnel comply with professional standards and applicable regulatory and legal requirements, and that the firm or engagement partners issue reports that are appropriate in the circumstances. QC section 10, *A Firm's System of Quality Control* (AICPA, *Professional Standards*), addresses a CPA firm's responsibilities for its system of quality control for its accounting and auditing practice. That section is to be read in conjunction with the AICPA Code of Professional Conduct and other relevant ethical requirements.

1.02 A system of quality control consists of policies designed to achieve the objectives of the system and the procedures necessary to implement and monitor compliance with those policies. The nature, extent, and formality of a firm's quality control policies and procedures will depend on various factors such as the firm's size; the number and operating characteristics of its offices; the degree of authority allowed to, and the knowledge and experience possessed by, firm personnel; and the nature and complexity of the firm's practice.

Communication of Quality Control Policies and Procedures

1.03 The firm should communicate its quality control policies and procedures to its personnel. Most firms will find it appropriate to communicate their policies and procedures in writing and distribute them, or make them available electronically, to all professional personnel. Effective communication includes the following:

- A description of quality control policies and procedures and the objectives they are designed to achieve
- The message that each individual has a personal responsibility for quality
- A requirement for each individual to be familiar with and to comply with these policies and procedures

Effective communication also includes procedures for personnel to communicate their views or concerns on quality control matters to the firm's management.

Elements of a System of Quality Control

1.04 A firm must establish and maintain a system of quality control. The firm's system of quality control should include policies and procedures that address each of the following elements of quality control identified in paragraph .17 of QC section 10:

[fn 1] The term *reasonable assurance*, which is defined as a high, but not absolute, level of assurance, is used because absolute assurance cannot be attained. Paragraph .53 of QC section 10, *A Firm's System of Quality Control* (AICPA, *Professional Standards*), states, "Any system of quality control has inherent limitations that can reduce its effectiveness."

- Leadership responsibilities for quality within the firm (the "tone at the top")
- Relevant ethical requirements
- Acceptance and continuance of client relationships and specific engagements
- Human resources
- Engagement performance
- Monitoring

1.05 The elements of quality control are interrelated. For example, a firm continually assesses client relationships to comply with relevant ethical requirements, including independence, integrity, and objectivity, and policies and procedures related to the acceptance and continuance of client relationships and specific engagements. Similarly, the human resources element of quality control encompasses criteria related to professional development, hiring, advancement, and assignment of firm personnel to engagements, all of which affect policies and procedures related to engagement performance. In addition, policies and procedures related to the monitoring element of quality control enable a firm to evaluate whether its policies and procedures for each of the other five elements of quality control are suitably designed and effectively applied.

1.06 Policies and procedures established by the firm related to each element are designed to achieve reasonable assurance with respect to the purpose of that element. Deficiencies in policies and procedures for an element may result in not achieving reasonable assurance with respect to the purpose of that element; however, the system of quality control, as a whole, may still be effective in providing the firm with reasonable assurance that the firm and its personnel comply with professional standards and applicable regulatory and legal requirements and that the firm or engagement partners issue reports that are appropriate in the circumstances.

1.07 If a firm merges, acquires, sells, or otherwise changes a portion of its practice, the surviving firm evaluates and, as necessary, revises, implements, and maintains firm-wide quality control policies and procedures that are appropriate for the changed circumstances.

Leadership Responsibilities for Quality Within the Firm (the "Tone at the Top")

1.08 The purpose of the leadership responsibilities element of a system of quality control is to promote an internal culture based on the recognition that quality is essential in performing engagements. The firm should establish and maintain the following policies and procedures to achieve this purpose:

- Require the firm’s leadership (managing partner, board of managing partners, CEO, or equivalent) to assume ultimate responsibility for the firm’s system of quality control.
- Provide the firm with reasonable assurance that personnel assigned operational responsibility for the firm’s quality control system have sufficient and appropriate experience and ability to identify and understand quality control issues and develop appropriate policies and procedures, as well as the necessary authority to implement those policies and procedures.

1.09 Establishing and maintaining the following policies and procedures assists firms in recognizing that the firm's business strategy is subject to the overarching requirement for the firm to achieve the objectives of the system of quality control in all the engagements that the firm performs:

- Assign management responsibilities so that commercial considerations do not override the quality of the work performed.
- Design policies and procedures addressing performance evaluation, compensation, and advancement (including incentive systems) with regard to personnel to demonstrate the firm's overarching commitment to the objectives of the system of quality control.
- Devote sufficient and appropriate resources for the development, communication, and support of its quality control policies and procedures.

Relevant Ethical Requirements

1.10 The purpose of the relevant ethical requirements element of a system of quality control is to provide the firm with reasonable assurance that the firm and its personnel comply with relevant ethical requirements when discharging professional responsibilities. Relevant ethical requirements include independence, integrity, and objectivity. Establishing and maintaining policies such as the following assist the firm in obtaining this assurance:

- Require that personnel adhere to relevant ethical requirements such as those in regulations, interpretations, and rules of the AICPA, state CPA societies, state boards of accountancy, state statutes, the U.S. Government Accountability Office, and any other applicable regulators.
- Establish procedures to communicate independence requirements to firm personnel and, where applicable, others subject to them.
- Establish procedures to identify and evaluate possible threats to independence and objectivity, including the familiarity threat that may be created by using the same senior personnel on an audit or attest engagement over a long period of time, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards.
- Require that the firm withdraw from the engagement if effective safeguards to reduce threats to independence to an acceptable level cannot be applied.
- Require written confirmation, at least annually, of compliance with the firm's policies and procedures on independence from all firm personnel required to be independent by relevant requirements.
- Establish procedures for confirming the independence of another firm or firm personnel in associated member firms who perform part of the engagement. This would apply to national firm personnel, foreign firm personnel, and foreign-associated firms. [fn 2]

[fn 2] A *foreign-associated firm* is a firm domiciled outside of the United States and its territories that is a member of, correspondent with, or similarly associated with an international firm or international association of firms.

- Require the rotation of personnel for audit or attest engagements where regulatory or other authorities require such rotation after a specified period.

Acceptance and Continuance of Client Relationships and Specific Engagements

1.11 The purpose of the quality control element that addresses acceptance and continuance of client relationships and specific engagements is to establish criteria for deciding whether to accept or continue a client relationship and whether to perform a specific engagement for a client. A firm's client acceptance and continuance policies represent a key element in mitigating litigation and business risk. Accordingly, it is important that a firm be aware that the integrity and reputation of a client's management could reflect the reliability of the client's accounting records and financial representations and, therefore, affect the firm's reputation or involvement in litigation. A firm's policies and procedures related to the acceptance and continuance of client relationships and specific engagements should provide the firm with reasonable assurance that it will undertake or continue relationships and engagements only where it

- is competent to perform the engagement and has the capabilities, including the time and resources, to do so;
- can comply with legal and relevant ethical requirements;
- has considered the client's integrity and does not have information that would lead it to conclude that the client lacks integrity; and
- has reached an understanding with the client regarding the services to be performed.

1.12 This assurance should be obtained before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. Establishing and maintaining policies such as the following assist the firm in obtaining this assurance:

- Evaluate factors that have a bearing on management's integrity and consider the risk associated with providing professional services in particular circumstances. [fn 3]
- Evaluate whether the engagement can be completed with professional competence; undertake only those engagements for which the firm has the capabilities, resources, and professional competence to complete; and evaluate, at the end of specific periods or upon occurrence of certain events, whether the relationship should be continued.
- Obtain an understanding, preferably in writing, with the client regarding the services to be performed.

[fn 3] Such considerations would include the risk of providing professional services to significant clients or to other clients for which the practitioner's objectivity or the appearance of independence may be impaired. In broad terms, the significance of a client to a member or a firm refers to relationships that could diminish a practitioner's objectivity and independence in performing attest services. Examples of factors to consider in determining the significance of a client to an engagement partner, office, or practice unit include (*a*) the amount of time the partner, office, or practice unit devotes to the engagement, (*b*) the effect on the partner's stature within the firm as a result of his or her service to the client, (*c*) the manner in which the partner, office, or practice unit is compensated, or (*d*) the effect that losing the client would have on the partner, office, or practice unit.

- Establish procedures on continuing an engagement and the client relationship, including procedures for dealing with information that would have caused the firm to decline an engagement if the information had been available earlier.

- Require documentation of how issues relating to acceptance or continuance of client relationships and specific engagements were resolved.

Human Resources

1.13 The purpose of the human resources element of a system of quality control is to provide the firm with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary (*a*) to perform its engagements in accordance with professional standards and regulatory and legal requirements, and (*b*) to enable the firm to issue reports that are appropriate in the circumstances. Establishing and maintaining policies such as the following assist the firm in obtaining this assurance:

- Recruit and hire personnel of integrity who possess the characteristics that enable them to perform competently.

- Determine capabilities and competencies required for an engagement, especially for the engagement partner, based on the characteristics of the particular client, industry, and kind of service being performed. Specific competencies necessary for an engagement partner are discussed in paragraph .A27 of QC section 10.

- Determine the capabilities and competencies possessed by personnel.

- Assign the responsibility for each engagement to an engagement partner.

- Assign personnel based on the knowledge, skills, and abilities required in the circumstances and the nature and extent of supervision needed.

- Have personnel participate in general and industry-specific continuing professional education and professional development activities that enable them to accomplish assigned responsibilities and satisfy applicable continuing professional education requirements of the AICPA, state boards of accountancy, and other regulators.

- Select for advancement only those individuals who have the qualifications necessary to fulfill the responsibilities they will be called on to assume.

Engagement Performance

1.14 The purpose of the engagement performance element of quality control is to provide the firm with reasonable assurance (*a*) that engagements are consistently performed in accordance with applicable professional standards and regulatory and legal requirements, and (*b*) that the firm or the engagement partner issues reports that are appropriate in the circumstances. Policies and procedures for engagement performance should address all phases of the design and execution of the engagement, including engagement performance, supervision responsibilities, and review responsibilities. Policies and procedures also should require that consultation takes place when appropriate. In addition, a policy should establish criteria against which all engagements are to be evaluated to determine whether an engagement quality control review should be performed.

1.15 Establishing and maintaining policies such as the following assist the firm in obtaining the assurance required relating to the engagement performance element of quality control:

- Plan all engagements to meet professional, regulatory, and the firm's requirements.
- Perform work and issue reports and other communications that meet professional, regulatory, and the firm's requirements.
- Require that work performed by other team members be reviewed by qualified engagement team members, which may include the engagement partner, on a timely basis.
- Require the engagement team to complete the assembly of final engagement files on a timely basis.
- Establish procedures to maintain the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation.
- Require the retention of engagement documentation for a period of time sufficient to meet the needs of the firm, professional standards, laws, and regulations.
- Require that
  - — consultation take place when appropriate (for example, when dealing with complex, unusual, unfamiliar, difficult, or contentious issues);
  - — sufficient and appropriate resources be available to enable appropriate consultation to take place;
  - — all the relevant facts known to the engagement team be provided to those consulted;
  - — the nature, scope, and conclusions of such consultations be documented; and
  - — the conclusions resulting from such consultations be implemented.
- Require that
  - — differences of opinion be dealt with and resolved;
  - — conclusions reached are documented and implemented; and
  - — the report not be released until the matter is resolved.
- Require that
  - — all engagements be evaluated against the criteria for determining whether an engagement quality control review should be performed;
  - — an engagement quality control review be performed for all engagements that meet the criteria; and
  - — the review be completed before the report is released.

- Establish procedures addressing the nature, timing, extent, and documentation of the engagement quality control review.

- Establish criteria for the eligibility of engagement quality control reviewers.

Monitoring

1.16 The purpose of the monitoring element of a system of quality control is to provide the firm and its engagement partners with reasonable assurance that the policies and procedures related to the system of quality control are relevant, adequate, operating effectively, and complied with in practice. Monitoring involves an ongoing consideration and evaluation of the appropriateness of the design, the effectiveness of the operation of a firm's quality control system, and a firm's compliance with its quality control policies and procedures. The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of the following:

- Adherence to professional standards and regulatory and legal requirements

- Whether the quality control system has been appropriately designed and effectively implemented

- Whether the firm's quality control policies and procedures have been operating effectively so that reports issued by the firm are appropriate in the circumstances

1.17 Establishing and maintaining policies such as the following assist the firm in obtaining the assurance required relating to the monitoring element of quality control:

- Assign responsibility for the monitoring process to a partner or partners or other persons with sufficient and appropriate experience and authority in the firm to assume that responsibility.

- Assign performance of the monitoring process to competent individuals.

- Require the performance of monitoring procedures that are sufficiently comprehensive to enable the firm to assess compliance with all applicable professional standards and the firm's quality control policies and procedures. Monitoring procedures consist of the following:

  — Review of selected administrative and personnel records pertaining to the quality control elements.

  — Review of engagement documentation, reports, and clients' financial statements.

  — Summarization of the findings from the monitoring procedures, at least annually, and consideration of the systemic causes of findings that indicate that improvements are needed.

  — Determination of any corrective actions to be taken or improvements to be made with respect to the specific engagements reviewed or the firm's quality control policies and procedures.

  — Communication of the identified findings to appropriate firm management personnel.

— Consideration of findings by appropriate firm management personnel who should also determine that any actions necessary, including necessary modifications to the quality control system, are taken on a timely basis.

— Assessment of

  - the appropriateness of the firm's guidance materials and any practice aids;
  - new developments in professional standards and regulatory and legal requirements and how they are reflected in the firm's policies and procedures where appropriate;
  - compliance with policies and procedures on independence;
  - the effectiveness of continuing professional development, including training;
  - decisions related to acceptance and continuance of client relationships and specific engagements; and
  - firm personnel's understanding of the firm's quality control policies and procedures and implementation thereof.

- Communicate at least annually, to relevant engagement partners and other appropriate personnel, deficiencies noted as a result of the monitoring process and recommendations for appropriate remedial action.
- Communicate the results of the monitoring of its quality control system process to relevant firm personnel at least annually.
- Establish procedures designed to provide the firm with reasonable assurance that it deals appropriately with the following:

  — Complaints and allegations that the work performed by the firm fails to comply with professional standards and regulatory and legal requirements.

  — Allegations of noncompliance with the firm's system of quality control.

  — Deficiencies in the design or operation of the firm's quality control policies and procedures, or noncompliance with the firm's system of quality control by an individual or individuals, as identified during the investigations into complaints and allegations.

  This includes establishing clearly defined channels for firm personnel to raise any concerns in a manner that enables them to come forward without fear of reprisal and documenting complaints and allegations and the responses to them.

- Require appropriate documentation to provide evidence of the operation of each element of its system of quality control. The form and content of documentation evidencing the operation of each of the elements of the system of quality control is a matter of judgment and depends on a number of factors, including the following, for example:

— The size of the firm and the number of offices.

— The nature and complexity of the firm's practice and organization.

- Require retention of documentation providing evidence of the operation of the system of quality control for a period of time sufficient to permit those performing monitoring procedures and peer review to evaluate the firm's compliance with its system of quality control, or for a longer period if required by law or regulation.

1.18 Some of the monitoring procedures discussed in the previous list may be accomplished through the performance of the following:

- Engagement quality control review
- Review of engagement documentation, reports, and clients' financial statements for selected engagements after the report release date
- Inspection [fn 4] procedures

Documentation of Quality Control Policies and Procedures

1.19 The firm should document each element of its system of quality control. The extent of the documentation will depend on the size, structure, and nature of the firm's practice. Documentation may be as simple as a checklist of the firm's policies and procedures or as extensive as practice manuals.

Applying the Quality Control Standards to Four Hypothetical Firms

1.20 Subsequent chapters in this practice aid present four different hypothetical firms and the quality control policies and procedures each firm implements to address each of the quality control elements. Following is a description of those firms and their characteristics:

- Multioffice CPA Firm has 10 offices in 3 states and is centrally managed. It has approximately 15 partners and 100 professionals. Its accounting and auditing practice has a concentration of financial institution clients for which it performs audit and attest services. Multioffice CPA Firm has no issuer clients. (Chapter 2, "System of Quality Control for a CPA Firm's Accounting and Auditing Practice—Firm With Multiple Offices")
- Singleoffice CPA Firm has 1 office, 3 partners, and 10 professionals. Its accounting and auditing practice has a concentration of employee benefit plan audits. Singleoffice CPA Firm has no issuer clients. (Chapter 3, "System of Quality Control for a CPA Firm's Accounting and Auditing Practice—Firm With a Single Office")

[fn 4] *Inspection* is a retrospective evaluation of the adequacy of the firm's quality control policies and procedures, its personnel's understanding of those policies and procedures, and the extent of the firm's compliance with them. Although monitoring procedures are meant to be ongoing, they may include inspection procedures performed at a fixed point in time. Monitoring is a broad concept; inspection is one specific type of monitoring procedure.

- Sole Practitioner, CPA, is a sole owner who has no professional staff and occasionally hires per diem professionals. Her accounting practice consists only of engagements subject to Statements on Standards for Accounting and Review Services. (Chapter 4, “System of Quality Control for a CPA Firm’s Accounting and Auditing Practice—Sole Practitioner”) (Note: Sole practitioners who perform audit and attest engagements should refer to chapter 3)

- Closely Aligned CPA Firm and Non-CPA-Owned Entity are organized in an *alternative practice structure*, which is a nontraditional structure in the practice of public accounting consisting of an attest and a nonattest portion of the practice. The attest portion is conducted through a firm, Closely Aligned CPA Firm, owned and controlled by CPAs. The nonattest portion is conducted through a separate entity, Non-CPA-owned Entity, owned and controlled by individuals who are not CPAs. (Chapter 5, “System of Quality Control for an Alternative Practice Structure”)

1.21 The policies and procedures described in each chapter are those that a firm of a similar size and type may consider establishing and maintaining. The policies and procedures used by an actual firm need not necessarily include nor be limited to all those used by the illustrative firms.

Chapter 2

System of Quality Control for a CPA Firm's Accounting and Auditing Practice — Firm With Multiple Offices

2.01 This chapter describes how a CPA firm that has multiple offices (Multioffice CPA Firm) implements each element of quality control in its accounting and auditing practice. Multioffice CPA Firm is a hypothetical firm that has 10 offices in 3 states and is centrally managed. Multioffice CPA Firm has 15 partners, 100 professionals, and a concentration of financial institution clients for which it performs audit and attest services. The firm uses practice aids that have been subjected to peer review in accordance with standards established by the AICPA. These practice aids are supplemented by oral and written communications from the firm's partners. It has no issuer clients. [fn 1]

Quality Control Policies and Procedures

2.02 The firm's system of quality control consists of policies designed to achieve the objectives of the system and the procedures necessary to implement and monitor compliance with those polices. The policies and procedures are required to be documented. Multioffice CPA Firm documents its system of quality control by preparing a document that comprehensively describes policies and procedures established and maintained for each element of quality control. Multioffice CPA Firm reviews the documentation at least annually and updates it as necessary.

2.03 The firm should communicate its quality control policies and procedures to its personnel. Effective communication includes the following:

- A description of quality control policies and procedures and the objectives they are designed to achieve
- The message that each individual has a personal responsibility for quality

2.04 Multioffice CPA Firm communicates these policies and procedures in writing and makes the documentation available electronically to all professional personnel. Multioffice CPA Firm requires each individual to be familiar with and to comply with these policies and procedures. Multioffice CPA Firm also includes procedures for personnel to communicate their views or concerns on quality control matters to partners.

Leadership Responsibilities for Quality Within the Firm (the "Tone at the Top")

2.05 The purpose of the leadership responsibilities element of a system of quality control is to promote an internal culture based on the recognition that quality is essential in performing engagements. Multioffice CPA Firm satisfies this purpose by establishing and maintaining the policies and procedures described in paragraphs 2.06–.10.

[fn 1] If Multioffice CPA Firm were to be engaged to perform audit services for an issuer, it might need to revise its quality control policies and procedures to comply with PCAOB standards and to reflect SEC requirements applicable to audits of issuers.

2.06 *Policy 1: The firm's managing partner assumes ultimate responsibility for the firm's system of quality control.* Multioffice CPA Firm implements this policy through the following procedures:

- Having the managing partner accept overall responsibility for the firm's system of quality control and promoting a quality-oriented culture by sending clear, consistent, and frequent messages through e-mails, letters, and recordings
- Having a mission statement that includes the firm's core values and the importance of quality
- Informing personnel that failure to adhere to the firm's policies and procedures regarding performance quality and commitment to ethical principles may result in disciplinary action

2.07 *Policy 2: The firm assigns management responsibilities so that commercial considerations do not override the quality of the work performed.* Multioffice CPA Firm implements this policy through the following procedures:

- Having the managing partner continually evaluate client relationships and specific engagements so that commercial considerations do not override the objectives of the system of quality control
- Emphasizing to all personnel that fee considerations and scope of services should not infringe upon quality work

2.08 *Policy 3: The firm assigns operational responsibility for the firm's quality control system to personnel who have sufficient and appropriate experience and ability to identify and understand quality control issues and to develop appropriate policies and procedures, as well as the necessary authority to implement those policies and procedures.* Multioffice CPA Firm implements this policy through the following procedures:

- Designating a quality control partner with overall operational responsibility for developing and implementing appropriate policies and procedures for the firm's quality control system
- Designating a quality control individual for each office

2.09 *Policy 4: The firm designs procedures addressing performance evaluation, compensation, and advancement (including incentive systems) with regard to personnel to demonstrate the firm's overarching commitment to the objectives of the system of quality control.* Multioffice CPA Firm implements this policy through the following procedures:

- Designing and implementing performance evaluation and advancement systems that (*a*) reward partners and staff involved in the accounting and auditing practice for the quality of their work and their compliance with professional standards and (*b*) include partner performance peer evaluations
- Establishing a compensation system that provides incentives to accounting and auditing partners and senior-level employees for the quality of their accounting and auditing work. The compensation system does the following:
    - — Takes into consideration firm feedback based on monitoring results and peer reviews of the work performed

— Rewards partners and personnel for timely (*a*) identification of significant and emerging accounting and auditing issues and (*b*) consultation with firm experts

2.10 *Policy 5: The firm devotes sufficient and appropriate resources for the development, communication, and support of its quality control policies and procedures.* Multioffice CPA Firm implements this policy through the following procedures:

- Providing the designated quality control partner with sufficient time, authority, and resources to develop, implement, and maintain the firm's quality control policies and procedures
- Providing the firm's quality control documentation to personnel when they are initially hired and reviewing the documentation with them
- Reviewing the firm's quality control policies and procedures with personnel at firm training sessions at least annually

Relevant Ethical Requirements

2.11 The purpose of the relevant ethical requirements element of a system of quality control is to provide the firm with reasonable assurance that the firm and its personnel comply with relevant ethical requirements when discharging professional responsibilities. Relevant ethical requirements include independence, integrity, and objectivity. Multioffice CPA Firm obtains this assurance by establishing and maintaining the policies and procedures described in paragraphs 2.12–.18.

2.12 *Policy 1: Personnel adhere to relevant ethical requirements such as those in regulations, interpretations, and rules of the AICPA, state CPA societies, state boards of accountancy, state statutes, the U.S. Government Accountability Office, and any other applicable regulators.* Multioffice CPA Firm implements this policy through the following procedures:

- Assigning one of its partners the responsibility of responding to questions, resolving matters, and determining the circumstances for which consultation with sources outside the firm is required for matters related to independence, integrity, and objectivity
- Identifying circumstances for which documentation of the resolution of matters is appropriate
- Maintaining a current list of (*a*) all entities with which firm personnel are prohibited from having a financial or business relationship and (*b*) all activities in which the firm is prohibited [fn 2] from engaging, as defined in the firm's independence policies
- Establishing clear and concise written independence guidance covering relationships and activities that impair independence, including but not limited to investments, loans, brokerage accounts, business relationships, employment relationships, and fee arrangements

[fn 2] Examples of prohibited activities include providing certain valuation and information technology services to an audit client. See the rules of specific standard-setters to determine the extent and relevance of any prohibition.

2.13 *Policy 2: The firm establishes procedures to communicate independence requirements to firm personnel and, where applicable, others subject to them.* Multioffice CPA Firm implements this policy through the following procedures:

- Having the managing partner (through e-mails, letters, or recordings) emphasize the concepts of independence, integrity, and objectivity in the firm's professional development meetings, in the acceptance and continuance of clients and engagements, and in the performance of engagements. Because Multioffice CPA Firm has a concentration of financial institution clients, this also includes discussing the applicability of these concepts to engagements for financial institutions, such as the prohibition against any member of the engagement team having a "nongrandfathered" loan with the institution, and the types of nonattest services that could affect independence.

- Requiring periodic independence and ethics training for all professional personnel. Such training covers the firm's independence and ethics policies and the independence and ethics requirements of all applicable regulators.

- Providing frequent reminders of professional responsibilities to personnel, such as avoiding behavior that might be perceived as impairing their independence or objectivity.

- Informing personnel on a timely basis of those entities to which independence policies apply by doing the following:

  — Preparing and maintaining a list of entities with which firm personnel are prohibited from having a financial or business relationship.

  — Making the list available to personnel so they may evaluate their independence (including personnel new to the firm or an office).

  — Notifying personnel of changes in the list.

2.14 *Policy 3: The firm establishes procedures to identify and evaluate possible threats to independence and objectivity, including the familiarity threat that may be created by using the same senior personnel on an audit or attest engagement over a long period of time, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards.* Multioffice CPA Firm implements this policy through the following procedures:

- Assigning a partner who is not otherwise associated with the engagement, or who practices in an office other than the office that performs the attest engagement, to review the engagement

- Requiring approval of the assignment of engagement personnel by another partner or manager

- Rotating engagement partners periodically

- Establishing additional procedures that provide safeguards when the firm performs audit or other attest work for (*a*) significant clients or (*b*) clients at which partners or other senior personnel are offered key management positions, or accept offers of employment, by utilizing the procedures contained in paragraphs .07–.08 of the "Conceptual Framework for Independence" interpretation (AICPA, *Professional Standards*, ET sec. 1.210.010) of the "Independence Rule" (AICPA, *Professional Standards*, ET sec. 1.000.001).

- Designating a senior-level partner to be responsible for overseeing the adequate functioning of the firm's independence policies

- Implementing a system to identify investment holdings of partners and managers that might impair independence

- Requiring all professionals to report, on a timely basis when identified, apparent violations of independence, integrity, or objectivity policies involving themselves, their spouses, or their dependents and the corrective actions taken or proposed to be taken

- Establishing a requirement for all professional personnel to notify the managing partner in each office of any potential activities that might impair independence or violate ethics rules, including services provided to entities with which firm personnel are prohibited from having a business relationship

- Establishing a program that protects professional personnel who report potential ethics or independence violations to the proper parties in compliance with firm policy

- Requiring the managing partner in each office, or a person designated by the managing partner, to periodically review unpaid fees from clients to ascertain whether any outstanding amounts impair the firm's independence

- Developing guidance that sets forth the consequences for professional personnel who violate the firm's independence policies and procedures, including engaging in activities with entities with which firm personnel are prohibited from having a business relationship

- Requiring all professional personnel to review the list of entities with which firm personnel are prohibited from having a business relationship before a professional or the spouse or dependent of a professional obtains a security or financial interest in an entity

- Establishing criteria that determine the need for safeguards for engagements where monitoring procedures or peer review have identified weaknesses in previous years or the same senior personnel have been used for five years or more on an audit or attestation engagement

- Documenting any safeguards applied to eliminate threats to independence or reduce them to an acceptable level

- Promptly communicating identified breaches of these policies and procedures, and the required corrective actions, to (*a*) the engagement partner who, with the firm, needs to address the breach and (*b*) other relevant personnel in the firm and those subject to the independence requirements who need to take appropriate action

- Obtaining confirmation from the engagement partner and other relevant personnel that the required corrective actions have been taken

2.15 *Policy 4: The firm withdraws from engagements if effective safeguards to reduce threats to independence to an acceptable level cannot be applied.* Multioffice CPA Firm implements this policy through the following procedures:

- Consulting within the firm and, if necessary, with legal counsel and other parties when the firm believes that effective safeguards to reduce threats to independence to an acceptable level cannot be applied

- Withdrawing from engagements when effective safeguards to reduce threats to independence to an acceptable level cannot be applied

2.16 *Policy 5: The firm obtains written confirmation, at least annually, of compliance with its policies and procedures on independence from all firm personnel required to be independent by relevant requirements.* Multioffice CPA Firm implements this policy through the following procedures:

- Obtaining written representations from personnel, upon hire and on an annual basis, stating that they have read the firm's independence, integrity, and objectivity policies, understand the applicability of those policies to their activities, and have complied with the requirements of those policies since their last representation (such written representations are accompanied by the most current list of all entities with which firm personnel are prohibited from having a financial or business relationship)

- Assigning responsibility to the firm's quality-control partner for obtaining such written representations, reviewing independence compliance files for completeness, and resolving reported exceptions

- Requiring the engagement partner to sign a step in the engagement program attesting to compliance with independence requirements that apply to the engagement

2.17 *Policy 6: The firm establishes procedures for confirming the independence of another firm or firm personnel in associated member firms who perform part of an engagement.* Multioffice CPA Firm implements this policy through the following procedures:

- Describing in its policies and procedures manual the form and content of independence representations, and frequency with which they are to be obtained

- Requiring that such representations be documented

2.18 *Policy 7: The firm rotates personnel for audit or attest engagements where regulatory or other authorities require such rotation after a specified period.* Multioffice CPA Firm implements this policy by having the quality control partner monitor regulatory requirements for financial institutions and other entities and notifying partners of the need for rotation. Multioffice CPA Firm has decided to rotate partners assigned to audit financial institutions every five years.

Acceptance and Continuance of Client Relationships and Specific Engagements

2.19 The purpose of the quality control element that addresses acceptance and continuance of client relationships and specific engagements is to establish criteria for deciding whether to accept or continue a client relationship and whether to perform a specific engagement for a client. A firm's client acceptance and continuance policies represent a key element in mitigating litigation and business risk. Accordingly, it is important that a firm be aware that the integrity and reputation of a client's management could reflect the reliability of the client's accounting records and financial representations and, therefore, affect the firm's reputation or involvement in litigation. A firm's policies and procedures related to the acceptance

and continuance of client relationships and specific engagements should provide the firm with reasonable assurance that it will undertake or continue relationships and engagements only where it

- is competent to perform the engagement and has the capabilities, including the time and resources, to do so;
- can comply with legal and relevant ethical requirements;
- has considered the client's integrity and does not have information that would lead it to conclude the client lacks integrity; and
- has reached an understanding with the client regarding the services to be performed.

2.20 Multioffice CPA Firm obtains this assurance, both with respect to the initial period for which the firm is performing its service and for subsequent periods, by establishing and maintaining the policies and procedures described in paragraphs 2.21–.25.

2.21 *Policy 1: The firm evaluates factors that have a bearing on management's integrity and considers the risk associated with providing professional services in particular circumstances.* Multioffice CPA Firm implements this policy through the following procedures:

- Developing and maintaining a manual that contains policies and procedures related to the acceptance of prospective clients and the continuance of existing clients. Such policies and procedures state that the firm's clients should not present undue risks to the firm, including damage to the firm's reputation.
- Advising professional personnel that they are expected to be familiar with the firm's policies and procedures for the acceptance and continuance of clients.
- Obtaining and evaluating relevant information before accepting or continuing any client. The following are examples of such information:
  - — The nature and purpose of the services to be provided and management's understanding thereof.
  - — The identity of the client's principal owners, key management, related parties, and those charged with its governance.
  - — The nature of the client's operations, including its business practices, from sources such as annual reports, interim financial statements, reports to regulators, enforcement actions by regulators, and income tax returns.
  - — Information obtained from inquiries of third parties about the client, its principal owners, key management, and those charged with governance that may have a bearing on evaluating the client. Examples of such third parties are bankers, factors, legal counsel, credit services, investment bankers, underwriters, and other members of the financial or business community who may have applicable knowledge. Inquiries also might be made regarding management's attitude toward compliance with regulators or legislative requirements and the presence of control deficiencies, especially those that management is unwilling to correct.

- Communicating with the predecessor accountant or auditor when required or recommended by professional standards. This communication also includes inquiries regarding the nature of any disagreements and whether there is evidence of opinion shopping.

- Assessing management's commitment to implementing and maintaining effective internal control.

- Assessing management's commitment to the appropriate application of generally accepted accounting principles (GAAP).

- Conducting a background check of the business, its officers, and the person(s) in question by using an investigative firm and evaluating the information obtained regarding management's integrity. Background checks are conducted when the firm is unable to obtain sufficient information about the prospective client after completing the steps listed previously, or when there is an indication that management or someone affiliated with the prospective client may be less than reputable.

- Evaluating the risk of providing services to significant clients or to other clients for which the firm's independence or the appearance of independence may be impaired. In broad terms, the significance of a client to a firm refers to relationships that could diminish a practitioner's objectivity and independence in performing attest services. In determining the significance of a client, the firm considers (*a*) the amount of time the partner devotes to the engagement, (*b*) the effect on the partner's stature within the firm as a result of his or her service to the client, (*c*) the manner in which the partner is compensated, and (*d*) the effect that losing the client would have on the partner and the firm.

2.22 *Policy 2: The firm evaluates whether the engagement can be completed with professional competence; undertakes only those engagements for which the firm has the capabilities, resources, and professional competence to complete; and evaluates, at the end of specific periods or upon occurrence of certain events, whether the relationship should be continued.* Multioffice CPA Firm implements this policy through the following procedures:

- Evaluating whether the following are in place:

  — The practice office has sufficient personnel who have obtained or can reasonably expect to obtain the knowledge and expertise necessary to perform the engagement, including relevant regulatory or reporting requirements.

  — Specialists are available if needed, through, for example, the resources of another practice office or alternative source.

  — The firm is able to complete the engagement within the reporting deadline.

- Defining high-risk engagements.

- Specifying conditions that trigger the requirement between annual audits to reevaluate a client or engagement. The following are examples of such conditions:

  — Significant changes in the client, such as a major change in ownership, senior client personnel, directors, advisers, the nature of the business, or its financial stability.

— Changes in the nature or scope of the engagement, such as an initial public offering or a request to step down from an audit to a review engagement.

— Changes in the composition or strategic focus of the firm, such as the inability to replace the loss of key personnel who are particularly knowledgeable about a specialized industry or a decision by Multioffice CPA firm to discontinue services to clients in a particular industry.

— The existence of conditions that would have caused the firm to reject the engagement had such conditions existed at the time of the initial acceptance, such as aggressive earnings management, unreliable processes for developing accounting estimates, questionable estimates by management, questions regarding the entity's ability to continue as a going concern, and other factors that may increase the risk of being associated with the client.

— The client's delinquency in paying fees. (This may also affect the firm's independence.)

— Engagements for entities operating in highly specialized or regulated industries, such as financial institutions, governmental entities, and employee benefit plans.

— Engagements for entities in the development stage.

— Engagements in which the client has ignored prior recommendations, such as recommendations that address deficiencies in internal control.

- Obtaining relevant information to determine whether the relationship should be continued and establishing the frequency with which client continuance evaluations should be made.

- Evaluating the information obtained regarding acceptance or continuance of a client or engagement through the following activities:

  — The engagement partner assesses the information obtained about the client or the specific engagement, including information about the significance of the client to the firm, and makes a recommendation about whether the client or engagement should be accepted or continued.

  — The engagement partner completes a client acceptance form and submits it to the managing partner of the practice office for approval.

  — The engagement partner signs a step in the planning program noting that he or she has considered whether the client should be continued, and if conditions exist that trigger the requirement between annual audits to reevaluate a client or engagement, prepares a form documenting his or her rationale and conclusion regarding client continuance.

  — The partner responsible for the quality control function assesses and approves the recommendation made by the engagement partner. In certain defined circumstances, such as high-risk engagements, acceptance or continuance decisions also may require approval of the firm's managing partner.

- Establishing procedures for dealing with information that would have caused the firm to decline the engagement if the information had been available earlier.

2.23 *Policy 3: The firm obtains an understanding with the client regarding the services to be performed.* Multioffice CPA Firm implements this policy by requiring that for all engagements, the firm prepare a written engagement letter documenting the understanding with the client and obtain the client's signature on that letter, thus minimizing the risk of misunderstandings regarding the nature, scope, and limitations of the services to be performed.

2.24 *Policy 4: The firm establishes procedures on withdrawal from an engagement or from both the engagement and the client relationship.* Multioffice CPA Firm implements this policy through the following procedures:

- Discussing with the appropriate level of the client's management and those charged with its governance the appropriate action that the firm might take based on the relevant facts and circumstances

- Considering whether there is a professional, regulatory, or legal requirement for the firm to remain in place or for the firm to report to regulatory authorities the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal

- Discussing with the appropriate level of the client's management and those charged with its governance withdrawal from the engagement, or from both the engagement and the client relationship, if the firm determines that it is appropriate to withdraw

2.25 *Policy 5: The firm documents how issues relating to acceptance or continuance of client relationships and specific engagements were resolved.* Multioffice CPA Firm implements this policy by documenting, in a memorandum to the engagement files, significant issues, consultations, conclusions, and the basis for the conclusions relating to acceptance or continuance of client relationships and specific engagements.

Human Resources

2.26 The purpose of the human resources element of a system of quality control is to provide the firm with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary (*a*) to perform its engagements in accordance with professional standards and regulatory and legal requirements and (*b*) to enable the firm to issue reports that are appropriate in the circumstances. Multioffice CPA Firm obtains this assurance by establishing and maintaining the policies and procedures described in paragraphs 2.27–.33.

2.27 *Policy 1: Personnel who are hired possess the characteristics that enable them to perform competently.* Multioffice CPA Firm implements this policy by maintaining firm-wide hiring standards and evaluating the firm's personnel needs, including the following:

- Designating a partner or other qualified individual in each office to be responsible for evaluating the overall personnel needs in that practice office and establishing hiring objectives based on factors such as existing clientele, anticipated growth, personnel turnover, and individual advancement

- Developing and maintaining personnel policies and procedures that identify attributes, achievements, and experiences desired in entry-level and experienced personnel

- Establishing criteria for evaluating personal characteristics such as integrity, competence, and motivation

- Establishing guidelines for the additional procedures to be performed when hiring experienced personnel, such as performing background checks and inquiring about any outstanding regulatory actions

- Preparing budgets that identify personnel needs at all levels

- Identifying sources of employment candidates such as universities and executive recruiters

- Selecting and training the individuals who will be interviewing candidates or otherwise participating in the hiring process

- Summarizing and evaluating the results of the hiring process for each candidate, including approval by the managing partner, or a person designated by the managing partner, of all hiring decisions

2.28 *Policy 2: The firm determines capabilities and competencies required for an engagement, including those required of the engagement partner.* Multioffice CPA Firm implements this policy by specifying the competencies that the engagement partner for an accounting, auditing, or attest engagement (or other person responsible for supervising and signing or authorizing someone to sign the firm's report on such engagements) should possess. Such competencies include having an understanding of the following:

- The role of the firm's system of quality control and the AICPA Code of Professional Conduct, both of which play critical roles in ensuring the integrity of the accounting, auditing, and attest function to users of reports.

- The performance, supervision, and reporting aspects of the engagement, which ordinarily are gained through training or participation in similar engagements.

- The industry in which the client operates, including its organization and operating characteristics, sufficient to identify areas of high or unusual risk associated with the engagement and to evaluate the reasonableness of industry-specific estimates.

- The professional standards applicable to the engagement being performed and to the industry in which the client operates. Such standards include accounting, auditing, and attestation standards, as well as rules and regulations issued by applicable regulators.

- The skills that contribute to sound professional judgment, including the ability to exercise professional skepticism.

- How the organization uses information technology and the manner in which information systems are used to record and maintain financial information.

2.29 *Policy 3: The firm determines the capabilities and competencies possessed by personnel.* Multioffice CPA Firm implements this policy through the following procedures:

- Establishing criteria for evaluating personal characteristics such as integrity, competence, and motivation

- Evaluating personnel at least annually to determine their capabilities and competencies

2.30 *Policy 4: The firm assigns responsibility for each engagement to an engagement partner.* Multioffice CPA Firm implements this policy through the following procedures:

- Assigning the responsibility for each engagement to an engagement partner who has the appropriate capabilities, competence, authority, and time to perform the role
- Clearly defining and communicating the responsibilities of the partner to the engagement partner
- Communicating the identity and role of the partner to management and those charged with governance
- Developing and maintaining systems to monitor the workload and availability of engagement partners to enable these individuals to have sufficient time to adequately discharge their responsibilities

2.31 *Policy 5: The firm assigns personnel (including partners) based on the knowledge, skills, and abilities required in the circumstances and the nature and extent of supervision needed.* Multioffice CPA Firm implements this policy through the following procedures:

- Designating an appropriate person(s) in each office to be responsible for assigning personnel to engagements based on such factors as the following:
  - — Engagement type, size, significance, complexity, and risk profile
  - — Specialized experience or expertise required and competencies gained through previous experience or education
  - — Need for and availability of staff and supervisors
  - — Timing of the work to be performed
  - — Continuity and rotation of personnel
  - — Opportunities for on-the-job training
  - — Situations for which independence or objectivity concerns exist
- Designating a partner to be responsible for partner and manager assignments
- Requiring approval of partner and manager assignments from the industry partner or the quality assurance partner in the case of high-risk or significant client engagements
- Establishing a policy for monitoring the continuation and rotation of engagement partners

2.32 *Policy 6: Personnel participate in general and industry-specific continuing professional education (CPE) and professional development activities that enable them to accomplish assigned responsibilities and satisfy applicable CPE requirements of the AICPA, state CPA societies, state boards of accountancy, and other applicable regulators.* Multioffice CPA Firm implements this policy through the following procedures:

- Designating a partner to oversee the development of firm requirements and materials for a professional development program covering subjects relevant to the firm's clients and services. Such responsibilities include the following:

  — Encouraging personnel to pass the Uniform CPA Examination

  — Establishing guidelines for participation by personnel in professional development programs and considering the requirements of the AICPA, state boards of accountancy, and applicable regulators in establishing the firm's CPE requirements

  — Maintaining appropriate documentation evidencing that personnel have met the professional education requirements of the firm, the AICPA, state boards of accountancy, and other applicable regulators

  — Providing an orientation program and training for new personnel to inform them of their professional responsibilities and firm policies

  — Preparing and providing publications and programs to inform personnel of their responsibilities and opportunities

  — Developing in-house staff training programs that focus on general and industry-specific accounting and auditing subjects, including audits of financial institutions

- Communicating and distributing to personnel changes in accounting, auditing, attestation, and quality control standards, as well as independence, integrity, and objectivity requirements and the firm's guidance with respect to those standards and requirements

- Encouraging professional personnel at each level in the firm to participate in external professional development activities such as the following:

  — CPE courses

  — Meetings of professional organizations

  — Serving on professional committees

  — Writing for professional publications

  — Speaking to professional groups

2.33 *Policy 7: Personnel selected for advancement have the qualifications necessary to fulfill the responsibilities they will be called on to assume.* Multioffice CPA Firm implements this policy through the following procedures:

- Appointing a director of human resources to identify and communicate, in the firm's policies and procedures manual, the qualifications necessary to accomplish responsibilities at each professional level in the firm. This includes the following:

  — Establishing criteria for evaluating personnel at each professional level and for advancement to the next higher level of responsibility. Such criteria give recognition and reward

to the development and maintenance of competence and commitment to ethical principles.

— Developing evaluation forms for each professional staff classification, including partners. Such forms include evaluation of performance quality and adherence to ethical principals.

— Informing personnel that failure to adhere to the firm's policies and procedures regarding performance quality and commitment to ethical principles may result in disciplinary action.

- Assigning responsibility to a partner for making advancement and termination decisions for staff and recommendations to the firm's management committee for manager and partner-level advancement and termination. Such responsibilities include the following:

  — Identifying responsibilities and requirements for evaluation at each level and indicating who will prepare these evaluations and when they will be prepared

  — Reviewing evaluations on a timely basis with the individual being evaluated

- Advising personnel regarding their progress and career opportunities through the following procedures:

  — Evaluating employees annually and at the end of each assignment exceeding three weeks to provide feedback on performance.

  — Summarizing and reviewing with personnel their performance evaluations, including assessing their progress with the firm, at least annually. Considerations include past performance, future objectives of the firm and the individual, assignment preferences, and career opportunities.

  — Evaluating partners periodically by means of performance reviews, peer evaluations, or self-appraisals, as appropriate, to provide feedback and to determine whether they continue to have the qualifications to accomplish their assigned responsibilities and to assume additional responsibilities.

Engagement Performance

2.34 The purpose of the engagement performance element of quality control is to provide the firm with reasonable assurance (*a*) that engagements are consistently performed in accordance with applicable professional standards and regulatory and legal requirements and (*b*) that the firm or the engagement partner issues reports that are appropriate in the circumstances. Policies and procedures for engagement performance should address all phases of the design and execution of the engagement, including engagement performance, supervision responsibilities, and review responsibilities. Policies and procedures also should require that consultation takes place when appropriate. In addition, a policy should establish criteria against which all engagements are to be evaluated to determine whether an engagement quality control review should be performed. Multioffice CPA Firm obtains this assurance by establishing and maintaining the policies and procedures described in paragraphs 2.35–.45.

2.35 *Policy 1: Planning for engagements meets professional, regulatory, and the firm's requirements.* Multioffice CPA Firm implements this policy by developing, maintaining, and providing personnel with the

firm's policies and procedures manual that delineates the factors the engagement team should consider in the planning process and the extent of documentation of these considerations. Planning considerations may vary depending on the size and complexity of the engagement. Planning generally includes the following activities:

- Assigning responsibility to the engagement partner for planning the engagement and assigning responsibilities to appropriate personnel during the planning phase
- Developing or updating background information about the client
- Considering client significance to the firm
- Requiring, for all initial audit clients designated as high risk by the firm, an independent review of planning considerations by either the engagement quality control reviewer or another partner
- Requiring planning documentation that includes the following:
  - — Proposed work programs tailored to the specific engagement
  - — Staffing requirements, including the need for personnel with specialized knowledge who may have to be obtained from other practice offices
  - — Consideration of the economic conditions affecting the client and its industry and their potential effect on the conduct of the engagement
  - — Consideration of risks and how they may affect the procedures to be performed
  - — A budget that allocates sufficient time for the engagement to be performed in accordance with professional standards and the firm's quality control policies and procedures
  - — Evidence of review of planning by an independent review partner

2.36 *Policy 2: The engagement is performed, supervised, reviewed, documented, and reported (or communicated) in accordance with the requirements of professional standards, applicable regulators, and the firm.* Multioffice CPA Firm implements this policy by requiring personnel to comply with the firm's policies and procedures manual, which prescribes the following:

- How engagement teams are supervised during the course of an engagement, including briefing the engagement team on the objectives of their work
- The form and content of documentation of the work performed and conclusions reached, including forms, checklists, and questionnaires to be used in performing engagements
- The form in which instructions are to be given to other offices or other auditors performing part of an engagement and the extent to which such work is to be reviewed and documented
- The extent of overall engagement review required, at all professional levels, to ensure that the financial statements meet professional and firm presentation and disclosure requirements
- The extent of review to be performed of required communications to management and the board of directors

2.37 *Policy 3: Qualified engagement team members review work performed by other team members on a timely basis.* Multioffice CPA Firm implements this policy through the following procedures:

- Adhering to the following firm guidelines regarding review of documentation of the work performed and conclusions reached, the financial statements, and reports and documentation of the review process:

  — All reviewers are to possess appropriate experience, competence, authority, and responsibility and are to be given access to the firm's reference material and other resources.

  — For each engagement, there is to be appropriate documentation evidencing review of the documentation of the work performed and conclusions reached, the financial statements, and the report.

- Assigning responsibility for the review of all reports, financial statements, and documentation of the work performed and conclusions reached to an appropriate reviewer in accordance with procedures outlined in the firm's manual to obtain reasonable assurance of the following:

  — The nature, timing, and extent of procedures performed are consistent with risk assessments and the approach described in the planning documentation. Exceptions are appropriately investigated. The appropriateness of planned procedures should be reconsidered if significant changes in risk factors occur or are identified between the planning phase of the engagement and the execution of procedures.

  — Firm-prescribed forms, checklists, and questionnaires, tailored as appropriate, are used in performing and reporting on the engagement.

- Requiring a second review, by a partner or manager, of the report, financial statements, and selected documentation of the work performed and conclusions reached, as prescribed in the firm's policies and procedures manual. The extent of review varies based on the type of engagement. For example, engagements for financial institutions, high-risk engagements, and those performed for significant clients, as defined by the firm, receive an engagement quality control review.

- Reviewing engagement documentation to determine whether the following has occurred:

  — The work has been performed in accordance with professional standards and regulatory and legal requirements.

  — Significant findings and issues have been raised for further consideration.

  — Appropriate consultations have taken place, and the resulting conclusions have been documented and implemented.

  — The nature, timing, and extent of work performed are appropriate and do not need revision.

  — The work performed supports the conclusions reached and is appropriately documented.

  — The evidence obtained is sufficient and appropriate to support the report.

  — The objectives of the engagement procedures have been achieved.

2.38 *Policy 4: Engagement teams complete the assembly of final engagement files on a timely basis.* Multioffice CPA Firm implements this policy by completing the assembly of final engagement files in accordance with professional standards and applicable regulatory requirements, if any.

2.39 *Policy 5: The firm maintains the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation.* Multioffice CPA Firm implements this policy through the following procedures:

- Establishing and applying controls to accomplish the following:
  - — Clearly determine when and by whom engagement documentation was prepared and reviewed.
  - — Protect the integrity of the information at all stages of the engagement, especially when the information is shared within the engagement team or transmitted to other parties via electronic means.
  - — Prevent unauthorized changes to the engagement documentation.
  - — Allow access to the engagement documentation by the engagement team and other authorized parties as necessary to properly discharge their responsibilities.
- Requiring the use of a password by engagement team members and data encryption to restrict access to electronic engagement documentation to authorized users.
- Implementing appropriate back-up routines for electronic engagement documentation at appropriate stages during the engagement.
- Implementing procedures for properly distributing engagement documentation materials to the team members at the start of the engagement, preparing engagement documentation during the engagement, and assembling final documentation at the end of the engagement.
- Implementing procedures for restricting access to, and enabling proper distribution and confidential storage of, hardcopy engagement documentation.
- Implementing procedures regarding original paper documents that have been electronically scanned or otherwise copied to another media that accomplish the following:
  - — Generate scanned copies that contain the entire content of the original paper documentation, including manual signatures, cross-references, and annotations.
  - — Integrate the scanned copies into the engagement files, including indexing and signing off on the copies as necessary.
  - — Enable the scanned copies to be retrieved and printed as necessary.

2.40 *Policy 6: The firm retains engagement documentation for a period of time sufficient to meet the needs of the firm, professional standards, laws, and regulations.* Multioffice CPA Firm implements this policy through the following procedures:

- Establishing procedures that accomplish the following:

— Enable the retrieval of, and access to, the engagement documentation during the retention period, particularly in the case of electronic documentation because the underlying technology may be upgraded or changed over time.

— Provide, where necessary, a record of changes made to engagement documentation after the assembly of engagement files has been completed.

— Enable authorized external parties to access and review specific engagement documentation for quality control or other purposes.

- Retaining documentation for a specific period of time as appropriate for the nature of the engagement.

2.41 *Policy 7: The firm requires that consultation take place when appropriate; that sufficient and appropriate resources are available to enable appropriate consultation to take place; that all the relevant facts known to the engagement team are provided to those consulted; that the nature, scope, and conclusions of such consultations are documented; and that conclusions resulting from such consultations are implemented.* Multioffice CPA Firm implements this policy through the following procedures:

- Providing personnel with the firm's policies and procedures manual that specifies the firm's consultation policies and procedures. Areas or specialized situations for which the firm requires consultation include the following:

  — Application of newly issued technical pronouncements.

  — Industries with special accounting, auditing, or reporting requirements.

  — Emerging practice problems.

  — Choices among alternative GAAP upon initial adoption or when an accounting change is made.

  — Reissuance of a report, consideration of omitted procedures after a report has been issued, or subsequent discovery of facts that existed at the date a report was issued.

  — Filing requirements of regulators.

  — Meetings with regulators at which the firm is to be called upon to support the application of GAAP or generally accepted auditing standards that have been questioned.

  — Designating individuals within the firm as consultants in certain areas. Personnel are to consult with the designated individual when issues arise. If differences arise between the engagement partner and the consultant, the matter is to be resolved by the partner(s) responsible for the quality control function.

- Maintaining or providing access to adequate and up-to-date references, which includes materials related to specific industries, specialties, and regulatory requirements, in each office.

- Requiring that documentation of consultation include all relevant facts and circumstances, the sections of the professional literature used in making a determination, the conclusion reached, how the conclusions were implemented, and the signatures of the engagement partner and con-

sultant. This documentation is to be retained with the engagement documentation of the work performed and conclusions reached. At the discretion of the consultant, the documentation may be entered in a retrievable database to promote efficiencies in the consultation process and consistency in the resolution of similar issues.

2.42 *Policy 8: The firm deals with and resolves differences of opinion, documents and implements conclusions reached, and does not release the report until the matter is resolved.* Multioffice CPA Firm implements this policy through the following procedures:

- Requiring that all differences of professional judgment within an engagement team be resolved by the engagement and quality control partners, and the managing partner if necessary, and that the report not be released until the matter is resolved.

- Requiring that the resolution of the differences be appropriately documented. If members of the engagement team continue to disagree with the resolution, they may disassociate themselves from the resolution of the matter and may document that a disagreement continues to exist.

2.43 *Policy 9: The firm has criteria for determining whether an engagement quality control review should be performed; evaluates all engagements against the criteria; performs an engagement quality control review for all engagements that meet the criteria; and completes the review before the report is released.* Multioffice CPA Firm implements this policy by defining high-risk engagements and requiring that an engagement quality control review be performed for all high-risk engagements, engagements for financial institutions, and engagements performed for significant clients.

2.44 *Policy 10: The firm establishes procedures addressing the nature, timing, extent, and documentation of the engagement quality control review.* Multioffice CPA Firm implements this policy through the following procedures:

- Implementing procedures addressing the timing of the review. The firm has concluded that performing an engagement quality control review is not necessary to obtain sufficient appropriate audit evidence for audit engagements; therefore, the engagement quality control review does not need to be completed before the date of the auditor's report but is required to be completed before the report is released. When the engagement quality control review results in additional audit procedures being performed, the date of the auditor's report is changed to the date by which sufficient appropriate audit evidence has been obtained.

- Implementing procedures addressing the nature and extent of the review. The firm's procedures for audit and attestation engagements require that the engagement quality control reviewer do the following:

  — Discuss significant accounting, auditing, and financial reporting issues with the engagement partner, including matters for which there has been consultation.

  — Discuss with the engagement partner the engagement team's identification and audit of high-risk assertions, transactions, and account balances.

  — Review selected working papers relating to the significant judgments the engagement team made and the conclusions they reached.

— Review documentation of the resolution of significant accounting, auditing, and financial reporting issues, including documentation of consultation with firm personnel or external sources.

— Review the summary of uncorrected misstatements that are related to known and likely misstatements.

— Review additional engagement documentation to the extent considered necessary.

— Read the financial statements and report and consider whether the report is appropriate.

— Confirm with the engagement partner that there are no significant unresolved issues.

— Complete the review before the release of the report.

— Determine whether the issues raised in the review indicate a need to change the auditor's report date.

- Resolving conflicting opinions between the engagement partner and the engagement quality control reviewer regarding significant matters. The policy requires documentation of the resolution of conflicting opinions before the release of the audit report.

- Implementing procedures addressing documentation by the engagement quality control reviewer. The firm's procedures require documentation of the following:

  — That the procedures required by the firm's policies on engagement quality control review have been performed.

  — That the engagement quality control review has been completed before the report is released.

  — That no matters have come to the attention of the engagement quality control reviewer that would cause the reviewer to believe that the significant judgments the engagement team made and the conclusions they reached were not appropriate.

2.45 *Policy 11: The firm establishes criteria for the eligibility of engagement quality control reviewers.* Multioffice CPA Firm implements this policy by establishing the following criteria for an engagement quality control reviewer:

- Is not selected by the engagement partner

- Has sufficient technical expertise and experience

- Carries out his or her responsibilities with objectivity and due professional care without regard to the relative positions of the engagement partner and the engagement quality control reviewer

- Does not assume any of the responsibilities of the engagement partner or have responsibility for the audit of any significant subsidiaries, divisions, benefit plans, or affiliated or related entities

- Meets the independence requirements relating to the engagements reviewed, even though the engagement quality control reviewer is not a member of the engagement team

- Does not make decisions for the engagement team or participate in the performance of the engagement, except that the engagement partner may consult the engagement quality control reviewer at any stage during the engagement

Monitoring

2.46 The purpose of the monitoring element of a system of quality control is to provide the firm and its engagement partners with reasonable assurance that the policies and procedures related to the system of quality control are relevant, adequate, operating effectively, and complied with in practice. Monitoring involves an ongoing consideration and evaluation of the appropriateness of the design, the effectiveness of the operation of a firm's quality control system, and a firm's compliance with its quality control policies and procedures. The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of the following:

- Adherence to professional standards and regulatory and legal requirements
- Whether the quality control system has been appropriately designed and effectively implemented
- Whether the firm's quality control policies and procedures have been operating effectively so that reports that are issued by the firm are appropriate in the circumstances

2.47 Multioffice CPA Firm obtains this assurance by establishing and maintaining the policies and procedures described in paragraphs 2.48–.51.

2.48 *Policy 1: The firm assigns responsibility for the monitoring process to a partner and assigns performance of the monitoring process to competent individuals.* Multioffice CPA Firm implements this policy through the following procedures:

- Designating a partner with appropriate authority to be responsible for quality assurance, including ensuring that the firm's quality control policies and procedures and its methodologies remain relevant and adequate. Factors to be considered include the following:
  - — Mergers and divestitures of portions of the practice.
  - — Changes in professional standards and other regulatory requirements applicable to the firm's practice.
  - — Results of inspections and peer reviews.
  - — Reviews of litigation and regulatory enforcement actions against the firm and others.
  - — Changes in applicable AICPA membership requirements.
- Preparing inspection checklists and guidance materials or using materials prepared by the AICPA for performing inspection procedures.
- Determining whether personnel have been appropriately informed of their responsibilities for maintaining the firm's standards of quality in performing their duties.
- Identifying the need to take the following actions:

— Revise policies and procedures related to the other elements of quality control because they are ineffective or inappropriately designed.

— Improve compliance with firm policies and procedures related to the other elements of quality control.

- Assigning performance of the monitoring process to the designated quality control individual for each practice office.

2.49 *Policy 2: The firm performs monitoring procedures that are sufficiently comprehensive to enable the firm to assess compliance with all applicable professional standards and the firm's quality control policies and procedures.* Multioffice CPA Firm implements this policy through the following procedures:

- Developing and performing the firm's inspection program to obtain feedback about the effectiveness of the firm's policies and procedures.

- Reviewing the resolution of matters reported by professional personnel on independence-confirmation forms to determine that matters have been appropriately considered and resolved.

- Interviewing personnel at all professional management and staff levels to obtain information about operating procedures in practice offices, whether personnel are knowledgeable about firm policies and procedures, and whether such policies and procedures are being effectively communicated.

- Reviewing the following documentation to determine compliance with firm policies and procedures:

  — Personnel evaluations, including documentation of hiring and advancement decisions.

  — Documentation of client acceptance and continuance decisions.

  — Participants' evaluations of practice office training programs.

  — Professional development records of personnel.

  — Correspondence regarding the resolution of independence matters within the practice office.

- Developing a plan to test a sample of engagements for compliance with the firm's policies and procedures. Such a review may be preissuance or postissuance.

- Reviewing a cross-section of engagements from selected practice offices using the following criteria for inclusion in the sample selected:

  — Engagements involving all partners and managers who have significant accounting and auditing responsibilities in the selected offices.

  — Engagements for financial institutions.

  — First-year engagements.

  - — Significant client engagements.
  - — Specialized industries, with emphasis given to high-risk industries.
  - — Level of service performed (audit, review, compilation, and attestation).
  - — Level of attestation services performed (examination, review, and agreed-upon procedures).
  - — Engagements for which there have been complaints or allegations that the work performed by the firm fails to comply with professional standards, regulatory requirements, or the firm's system of quality control.
  - — Engagements in which there were significant disagreements between the quality review partner and the engagement partner.
- Periodically reviewing the process for personnel evaluation and counseling to ascertain the following:
  - — Procedures for evaluation and documentation are being followed on a timely basis.
  - — Personnel who have been promoted have achieved the applicable requirements for advancement.
  - — Personnel decisions are consistent with evaluations.
  - — Recognition is given to outstanding performance.
- Designating a partner or qualified individual in each office to review the summary of the evaluations of in-house training programs to determine whether the programs are achieving their objectives.
- Designating a partner or qualified individual in each office to review summaries of CPE records for that office's professional staff to determine that the office has established a means of tracking each individual's compliance with the requirements of the AICPA and other applicable regulators.
- Interviewing selected professional personnel regarding the effectiveness of training programs.
- Considering the results of the firm's inspection as they relate to the effectiveness of the firm's professional development program.
- Ascertaining whether inquiries received by individuals consulted within the firm indicate the need for additional CPE programs.
- Reviewing and updating firm practice aids, such as audit programs, forms, and checklists, to reflect new or revised professional pronouncements.
- Issuing guidance regarding new professional standards, regulatory requirements, and related changes to firm policy.

- Soliciting comments from partners and managers regarding the effectiveness of practice aids and tools.

2.50 *Policy 3: The firm communicates at least annually (a) deficiencies noted as a result of the monitoring process and recommendations for appropriate remedial action to relevant engagement partners and other appropriate personnel and (b) the results of the monitoring of its quality control system process to relevant firm personnel.* Multioffice CPA Firm implements this policy through the following procedures:

- Preparing a summary monitoring report for the firm's senior management that evaluates the overall results of the inspection and other monitoring procedures and reaches final conclusions regarding whether the firm as a whole needs to improve compliance with the firm's policies and procedures and whether revisions to the firm's quality control policies and procedures are necessary.

- Communicating findings to practice office personnel and determining the corrective actions to be taken for the engagements reviewed. These findings are discussed and communicated in a report issued to each office. The practice office responds regarding the specific corrective actions or steps to be taken to improve compliance with the firm's policies and procedures and professional standards.

- Following up on planned corrective actions to determine whether those actions were taken and whether they achieved the intended objective(s).

- Communicating in partner-manager meetings and firm policy correspondence the need for changes in the system of quality control.

- Communicating in training programs, partner-manager meetings, and firm policy correspondence the need for improved compliance with the system of quality control.

2.51 *Policy 4: The firm deals appropriately with complaints and allegations.* Multioffice CPA Firm implements this policy through the following procedures:

- Establishing procedures for concerns to be brought to the attention of the ethics committee in a confidential manner

- Having the firm's ethics committee (excluding any members who are otherwise involved in the engagement under investigation) investigate the following:

  — Complaints and allegations that the work performed by the firm fails to comply with professional standards and regulatory and legal requirements

  — Allegations of noncompliance with the firm's system of quality control

  — Deficiencies in the design or operation of the firm's quality control policies and procedures, or noncompliance with the firm's system of quality control by an individual or individuals, as identified during the investigations into complaints and allegations

- Consulting with legal counsel as necessary

- Documenting complaints and allegations and the responses to them

2.52 *Policy 5: The firm prepares appropriate documentation to provide evidence of the operation of each element of its system of quality control.* Multioffice CPA Firm implements this policy by designing its summary monitoring report to provide evidence of the operation of each element of its system of quality control, including the following:

- Monitoring procedures, including the procedure for selecting completed engagements to be inspected
- A record of the evaluation of the following:
  - — Adherence to professional standards and regulatory and legal requirements
  - — Whether the quality control system has been appropriately designed and effectively implemented
  - — Whether the firm's quality control policies and procedures have been appropriately applied
- Identification of the deficiencies noted, an evaluation of their effects, and the basis for determining whether further action is necessary and what that action should be

2.53 *Policy 6: The firm retains documentation providing evidence of the operation of the system of quality control for an appropriate period of time.* Multioffice CPA Firm implements this policy by requiring retention of the summary monitoring report for a period of time sufficient to meet the firm's peer review or other regulatory requirements.

Chapter 3

System of Quality Control for a CPA Firm's Accounting and Auditing Practice — Firm With a Single Office

3.01 This chapter describes how a CPA firm that has a single office (Singleoffice CPA Firm) implements each element of quality control in its accounting and auditing practice. Singleoffice CPA Firm is a hypothetical firm with 1 office, 3 partners, and a total of 10 professionals. Its accounting and auditing practice has a concentration of employee benefit plans, and the firm has no issuer clients.[fn 1] The firm uses practice aids that have been subjected to peer review in accordance with standards established by the AICPA. These practice aids are supplemented by oral and written communications from the firm's partners.

Quality Control Policies and Procedures

3.02 The firm's system of quality control consists of policies designed to achieve the objectives of the system and the procedures necessary to implement and monitor compliance with those polices. The policies and procedures are required to be documented. Singleoffice CPA Firm documents its system of quality control by preparing a document that comprehensively describes the policies and procedures for each element of quality control. Singleoffice CPA Firm reviews the documentation at least annually and updates it as necessary.

3.03 The firm should communicate its quality control policies and procedures to its personnel. Effective communication includes the following:

- A description of quality control policies and procedures and the objectives they are designed to achieve
- The message that each individual has a personal responsibility for quality

3.04 Singleoffice CPA Firm communicates these policies and procedures in writing and makes the documentation available electronically to all professional personnel. Singleoffice CPA Firm requires each individual to be familiar with and to comply with these policies and procedures. Singleoffice CPA Firm encourages its personnel to communicate their views or concerns about quality control matters to partners.

Leadership Responsibilities for Quality Within the Firm (the "Tone at the Top")

3.05 The purpose of the leadership responsibilities element of a system of quality control is to promote an internal culture based on the recognition that quality is essential in performing engagements. Singleoffice CPA Firm satisfies this purpose by establishing and maintaining the policies and procedures described in paragraphs 3.06–.10.

[fn 1] If Singleoffice CPA Firm were to be engaged to perform audit services for an issuer, it might need to revise its quality control policies and procedures to comply with PCAOB standards and to reflect SEC requirements applicable to audits of issuers.

3.06 *Policy 1: The firm's managing partner assumes ultimate responsibility for the firm's system of quality control.* Singleoffice CPA Firm implements this policy through the following procedures:

- Having the managing partner accept ultimate responsibility for the firm's system of quality control and for setting a tone that emphasizes the importance of quality and of following the firm's system of quality control

- Informing personnel that failure to adhere to the firm's policies and procedures regarding performance quality and commitment to ethical principles may result in disciplinary action

3.07 *Policy 2: Commercial considerations do not override the quality of the work performed.* Singleoffice CPA Firm implements this policy through the following procedures:

- Having the managing partner continually evaluate client relationships and specific engagements so that commercial considerations do not override the objectives of the system of quality control

- Emphasizing to all personnel that fee considerations and scope of services should not infringe upon quality work

3.08 *Policy 3: Responsibility for developing, implementing, and operating the firm's quality control system is assigned to personnel with sufficient and appropriate experience, authority, and ability.* Singleoffice CPA Firm implements this policy by having the managing partner designate a quality control partner who is responsible for designing, implementing, and monitoring the firm's quality control system.

3.09 *Policy 4: Performance evaluation, compensation, and advancement (including incentive systems) with regard to personnel demonstrate the firm's overarching commitment to the objectives of the system of quality control.* Singleoffice CPA Firm implements this policy through the following procedures:

- Designing and implementing performance evaluation and advancement systems that reward partners and staff involved in the accounting and auditing practice for the quality of their work and their compliance with professional standards.

- Establishing a compensation system that provides incentives to accounting and auditing partners and senior-level employees for the quality of their accounting and auditing work. The compensation system does the following:

  — Takes into consideration firm feedback based on monitoring results and peer reviews of the work performed.

  — Rewards partners and personnel for timely (*a*) identification of significant and emerging accounting and auditing issues and (*b*) consultation with firm experts.

3.10 *Policy 5: The firm devotes sufficient and appropriate resources for the development, communication, and support of its quality control policies and procedures.* Singleoffice CPA Firm implements this policy through the following procedures:

- Providing the designated quality control partner with sufficient time, authority, and resources to develop, implement, and maintain the firm's quality control policies and procedures

- Providing the firm's quality control documentation to personnel when they are initially hired and reviewing the documentation with them

- Reviewing the firm's quality control policies and procedures with personnel at firm training sessions at least annually

Relevant Ethical Requirements

3.11 The purpose of the relevant ethical requirements element of a system of quality control is to provide the firm with reasonable assurance that the firm and its personnel comply with relevant ethical requirements when discharging professional responsibilities. Relevant ethical requirements include independence, integrity, and objectivity. Singleoffice CPA Firm obtains this assurance by establishing and maintaining the policies and procedures described in paragraphs 3.12–.17.

3.12 *Policy 1: Personnel adhere to relevant ethical requirements such as those in regulations, interpretations, and rules of the AICPA, state CPA societies, state boards of accountancy, state statutes, the U.S. Government Accountability Office, and any other applicable regulators.* Singleoffice CPA Firm implements this policy through the following procedures:

- Designating a quality assurance partner to review relevant pronouncements relating to independence, integrity, and objectivity; answer questions; determine the circumstances for which consultation with sources outside the firm is required; and resolve matters

- Providing personnel with access to the AICPA *Professional Standards* service

- Establishing a system for identifying all services performed for each client and evaluating whether any of those services might impair independence

3.13 *Policy 2: The firm establishes procedures to communicate independence requirements to firm personnel and, where applicable, others subject to them.* Singleoffice CPA Firm implements this policy through the following procedures:

- Informing personnel of those entities to which independence policies apply by doing the following on a timely basis:

  — Preparing and maintaining a list of entities with which firm personnel are prohibited from having a financial or business relationship

  — Making the list available to personnel so they may evaluate their independence (including personnel new to the firm)

  — Notifying personnel of changes in the list

- Providing frequent reminders of professional responsibilities to personnel, such as avoiding behavior that might be perceived as impairing their independence or objectivity

3.14 *Policy 3: The firm establishes procedures to identify and evaluate possible threats to independence and objectivity, including the familiarity threat that may be created by using the same senior personnel on an audit or attest engagement over a long period of time, and to take appropriate action to eliminate*

those threats or reduce them to an acceptable level by applying safeguards. Singleoffice CPA Firm implements this policy through the following procedures:

- Requiring the engagement partner to consider relevant information about client engagements, including the scope of services, to enable him or her to evaluate the overall impact, if any, on independence requirements.

- Accumulating and communicating relevant information to appropriate personnel so that the following can occur:

  — The firm, the engagement partner, and other firm personnel can readily determine whether they satisfy independence requirements.

  — The firm can maintain and update information relating to independence.

  — The firm and the engagement partner can take appropriate action regarding identified threats to independence.

- Requiring personnel to promptly report circumstances and relationships that create a threat to independence, and independence breaches of which they become aware, so that appropriate action can be taken.

- Establishing criteria to determine the need for safeguards for engagements where the following have taken place:

  — Monitoring procedures or peer review has identified weaknesses in previous years.

  — The same senior personnel have been used for five years or more on an audit or attestation engagement.

- Promptly communicating identified breaches of these policies and procedures, and the required corrective actions, to the following personnel:

  — The engagement partner who, with the firm, needs to address the breach.

  — Other relevant personnel in the firm and those subject to the independence requirements who need to take appropriate action.

- Requiring the engagement partner and the other individuals referred to in the previous list to confirm to the firm that the required corrective actions have been taken.

- Having a partner, or an individual designated by the partner, periodically review unpaid fees from clients to ascertain whether any outstanding amounts impair the firm's independence.

- Establishing additional procedures that provide safeguards when the firm performs audit or other attest work for (*a*) significant clients or (*b*) clients at which partners or other senior personnel are offered key management positions or have accepted offers of employment.

3.15 *Policy 4: The firm withdraws from the engagement if effective safeguards to reduce threats to independence to an acceptable level cannot be applied.* Singleoffice CPA Firm implements this policy through the following procedures:

- Consulting within the firm, and with legal counsel and other parties if necessary, when the firm believes that effective safeguards to reduce threats to independence to an acceptable level cannot be applied

- Withdrawing from the engagement if effective safeguards to reduce threats to independence to an acceptable level cannot be applied

3.16 *Policy 5: The firm obtains written confirmation, at least annually, of compliance with its policies and procedures on independence from all firm personnel required to be independent by relevant requirements.* Singleoffice CPA Firm implements this policy through the following procedures:

- Obtaining written representations from personnel, upon hire and on an annual basis, stating that they have read the firm's independence, integrity, and objectivity policies, understand the applicability of those policies to their activities, and have complied with the requirements of those policies since their last representation. (Such written representations are accompanied by the most current list of all entities with which firm personnel are prohibited from having a business relationship.)

- Reviewing these independence representations for completeness and resolving reported exceptions.

- Requiring the engagement partner to sign a step in the engagement program attesting to compliance with independence requirements that apply to the engagement.

3.17 *Policy 6: The firm establishes procedures for confirming the independence of another firm that performs part of the engagement.* Singleoffice CPA Firm implements this policy through the following procedures:

- Using practice aids that prescribe the form and content of independence representations, and frequency with which they are to be obtained

- Requiring that such representations be documented

Acceptance and Continuance of Client Relationships and Specific Engagements

3.18 The purpose of the quality control element that addresses acceptance and continuance of client relationships and specific engagements is to establish criteria for deciding whether to accept or continue a client relationship and whether to perform a specific engagement for a client. A firm's client acceptance and continuance policies represent a key element in mitigating litigation and business risk. Accordingly, it is important that a firm be aware that the integrity and reputation of a client's management could reflect the reliability of the client's accounting records and financial representations and, therefore, affect the firm's reputation or involvement in litigation. A firm's policies and procedures related to the acceptance and continuance of client relationships and specific engagements should provide the firm with reasonable assurance that it will undertake or continue relationships and engagements only where it

- is competent to perform the engagement and has the capabilities, including the time and resources, to do so;

- can comply with legal and ethical requirements;

- has considered the client's integrity and does not have information that would lead it to conclude that the client lacks integrity; and

- has reached an understanding with the client regarding the services to be performed.

3.19 Singleoffice CPA Firm obtains this assurance, both with respect to the initial period for which the firm is performing its service and for subsequent periods, by establishing and maintaining the policies and procedures described in paragraphs 3.20–.24.

3.20 *Policy 1: The firm evaluates factors that have a bearing on management's integrity and considers the risk associated with providing professional services in particular circumstances.* Singleoffice CPA Firm implements this policy through the following procedures:

- Informing personnel of the firm's policies and procedures for accepting and continuing clients, including those outlined in the firm's practice aids.

- Obtaining and evaluating relevant information such as the following before accepting or continuing a client:

  — The nature and purpose of the services to be provided and management's understanding thereof.

  — The identity of the client's principal owners, key management, related parties, and those charged with its governance.

  — Information obtained from inquiries of the client's bankers, factors, attorneys, credit services, and others who have business relationships with the entity.

  — The nature of the client's operations, including its business practices, from sources such as annual reports, interim financial statements, reports to and from regulators, income tax returns, and credit reports.

  — Information concerning the attitude of the client's principal owners, key management, and those charged with its governance toward such matters as aggressive interpretation of accounting standards and internal control over financial reporting.

- Evaluating the risk of providing services for the following engagements:

  — Engagements for entities operating in highly specialized or regulated industries, including financial institutions, governmental entities, and employee benefit plans.

  — Engagements that require an inordinate amount of time to complete relative to the available resources of the firm.

- Communicating with the predecessor accountant or auditor when required or recommended by professional standards. This communication also includes inquiries regarding the nature of any disagreements and whether there is evidence of opinion-shopping.

- Conducting a background check of the business, its officers, and the person(s) in question by using the services of an investigative company and evaluating the information obtained regarding

management's integrity. Background checks are conducted when the firm is unable to obtain sufficient information about the prospective client after taking the steps described previously, or there is an indication that management or someone affiliated with the prospective client may be less than reputable.

- Evaluating the risk of providing services to significant clients or to other clients for which the firm's objectivity or the appearance of independence may be impaired. In broad terms, the significance of a client to a firm refers to relationships that could diminish a practitioner's objectivity and independence in performing attest services. In determining the significance of a client, the firm considers (*a*) the amount of time the partner devotes to the engagement, (*b*) the effect on the partner's stature within the firm as a result of his or her service to the client, (*c*) the manner in which the partner is compensated, and (*d*) the effect that losing the client would have on the partner and the firm.

3.21 *Policy 2: The firm evaluates whether the engagement can be completed with professional competence; undertakes only those engagements for which the firm has the capabilities, resources, and professional competence to complete; and evaluates, at the end of specific periods or upon occurrence of certain events, whether the relationship should be continued.* Singleoffice CPA Firm implements this policy through the following procedures:

- Evaluating whether the firm has obtained or can reasonably expect to obtain the knowledge and expertise necessary to perform the engagement, including relevant regulatory or reporting requirements.

- Evaluating whether the following are in place:

  — The firm has sufficient personnel with the necessary capabilities and competence.

  — Specialists are available if needed.

  — Individuals meeting the criteria and eligibility requirements to perform an engagement quality control review are available, when needed.

  — The firm is able to complete the engagement within the reporting deadline.

- Specifying conditions that trigger the requirement to reevaluate a specific client or engagement. The following are examples of such conditions:

  — Significant changes in the client, such as a major change in senior client personnel, ownership, advisers, the nature of its business, or the financial stability of the client.

  — Changes in the nature or scope of the engagement, including requests for additional services.

  — Changes in the composition of the firm, such as the loss of and inability to replace key personnel who are particularly knowledgeable about a specialized industry.

  — The decision to discontinue services to clients in a particular industry.

  — The existence of conditions that would have caused the firm to reject the client or engagement had such conditions existed at the time of the initial acceptance.

— The client's delinquency in paying fees. (This may also affect the firm's independence.)

— Engagements for entities operating in highly specialized or regulated industries, such as financial institutions, governmental entities, and employee benefit plans.

— Engagements for entities in which there may be substantial doubt about the entity's ability to continue as a going concern.

— Engagements in which the client has ignored prior recommendations, such as those that address deficiencies in internal control.

- Obtaining relevant information to determine whether the relationship should be continued and establishing a frequency for evaluations (for example, continuance decisions are made at least annually).

- Evaluating the information obtained regarding acceptance or continuance of the client or engagement through the following activities:

  — The engagement partner assesses the information obtained about the client or the specific engagement, including information about the significance of the client to the firm, and makes a recommendation about whether the client or engagement should be accepted or continued.

  — The engagement partner completes a client acceptance form and submits it to the managing partner for approval.

  — The engagement partner signs a step in the planning program noting consideration of client continuance and completes a form documenting the rationale and conclusion regarding client continuance if conditions exist that trigger the requirement to reevaluate a client or engagement between annual audits.

  — The managing partner assesses and approves the recommendation made by the engagement partner. If the managing partner recommends not accepting a client or discontinuing a client relationship, the managing partner discusses his or her reasons for the acceptance or continuance decision with the other partners.

- Establishing procedures for dealing with information that would have caused the firm to decline the engagement if the information had been available earlier.

3.22 *Policy 3: The firm obtains an understanding with the client regarding the services to be performed.* Singleoffice CPA Firm implements this policy by requiring that, for all engagements, the firm prepare a written engagement letter documenting the understanding with the client and obtain the client's signature on that letter, thus minimizing the risk of misunderstanding regarding the nature, scope, and limitations of the services to be performed.

3.23 *Policy 4: The firm establishes procedures on withdrawal from an engagement or from both the engagement and the client relationship.* Singleoffice CPA Firm implements this policy through the following procedures:

- Discussing with the appropriate level of the client's management and those charged with its governance the appropriate action that the firm might take based on the relevant facts and circumstances

- Considering whether there is a professional, regulatory, or legal requirement for the firm to remain in place or for the firm to report to regulatory authorities the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal

- Discussing with the appropriate level of the client's management and those charged with its governance withdrawal from the engagement or from both the engagement and the client relationship if the firm determines that it is appropriate to withdraw

3.24 *Policy 5: The firm documents how issues relating to acceptance or continuance of client relationships and specific engagements were resolved.* Singleoffice CPA Firm implements this policy by documenting, in a memorandum to the engagement files, significant issues, consultations, conclusions, and the basis for the conclusions relating to acceptance or continuance of client relationships and specific engagements.

Human Resources

3.25 The purpose of the human resources element of a system of quality control is to provide the firm with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary (*a*) to perform its engagements in accordance with professional standards and regulatory and legal requirements and (*b*) to enable the firm to issue reports that are appropriate in the circumstances. Singleoffice CPA Firm obtains this assurance by establishing and maintaining the policies and procedures described in paragraphs 3.26–.32.

3.26 *Policy 1: Personnel who are hired possess the characteristics that enable them to perform competently.* Singleoffice CPA Firm implements this policy through the following procedures:

- Designating an individual in the firm to be responsible for the following activities:

  — Managing the human resources function

  — Evaluating the firm's personnel needs by considering factors such as existing clientele, anticipated growth, personnel turnover, and individual advancement

  — Developing criteria for determining which individuals will be involved in the interviewing and hiring process

- Establishing an understanding among the partners about the attributes, achievements, and experiences desired in entry-level and experienced personnel

- Setting guidelines for the additional procedures to be performed when hiring experienced personnel, such as performing background checks and inquiring about any outstanding regulatory actions

3.27 *Policy 2: The firm determines capabilities and competencies required for an engagement, including those required of the engagement partner.* Singleoffice CPA Firm implements this policy by specifying

the competencies that the engagement partners of the firm's accounting, auditing, and attestation engagements (or other persons responsible for supervising and signing or authorizing someone to sign the firm's report on such engagements) should possess. These competencies include having an understanding of the following:

- The role of the firm's system of quality control and the AICPA Code of Professional Conduct in ensuring the integrity of the accounting, auditing, and attest functions to users of reports.
- The performance, supervision, and reporting aspects of the engagement, which ordinarily are gained through training or participation in similar engagements.
- The industry in which the client operates, including its organization and operating characteristics, sufficient to identify areas of high or unusual risk associated with the engagement and to evaluate the reasonableness of industry-specific estimates.
- The professional standards applicable to the engagement and the industry in which the client operates. Such standards include accounting, auditing, and attestation standards, as well as rules and regulations issued by applicable regulators.
- The skills that contribute to sound professional judgment, including the ability to exercise professional skepticism.
- How the organization uses information technology and the manner in which information systems are used to record and maintain financial information.

3.28 *Policy 3: The firm determines the capabilities and competencies possessed by personnel.* Singleoffice CPA Firm implements this policy through the following procedures:

- Establishing criteria for evaluating personal characteristics such as integrity, competence, and motivation
- Evaluating personnel at least annually to determine their capabilities and competencies

3.29 *Policy 4: The firm assigns the responsibility for each engagement to an engagement partner.* Singleoffice CPA Firm implements this policy through the following procedures:

- Assigning responsibility for each engagement to an engagement partner who has the appropriate capabilities, competence, authority, and time to perform the role
- Clearly defining and communicating the responsibilities of the partner to the engagement partner
- Communicating the identity and role of the partner to management and those charged with governance
- Monitoring the workload and availability of engagement partners to enable these individuals to have sufficient time to adequately discharge their responsibilities

3.30 *Policy 5: The firm assigns personnel (including partners) based on the knowledge, skills, and abilities required in the circumstances and the nature and extent of supervision needed.* Singleoffice CPA Firm implements this policy through the following procedures:

- Designating an appropriate person to be responsible for assigning personnel to engagements based on such factors as the following:
    - — Engagement type, size, significance, complexity, and risk profile
    - — Specialized experience and expertise required for the engagement and competencies gained through prior experience
    - — Personnel availability
    - — Timing of the work to be performed
    - — Continuity and rotation of personnel
    - — Opportunities for on-the-job training
    - — Situations for which independence or objectivity concerns exist
- Designating a partner to be responsible for partner and manager assignments
- Requiring approval of partner and manager assignments from the managing partner or other partner in the case of high-risk or significant client engagements

3.31 *Policy 6: Personnel participate in general and industry-specific continuing professional education (CPE) and professional development activities that enable them to accomplish assigned responsibilities and satisfy applicable CPE requirements of the AICPA, state CPA societies, state boards of accountancy, and other regulators.* Singleoffice CPA Firm implements this policy through the following procedures:

- Encouraging personnel to pass the Uniform CPA Examination
- Assigning responsibility to a partner to maintain a professional development program that does the following:
    - — Requires personnel to participate in professional development programs in accordance with firm guidelines and in subjects that are relevant to their responsibilities
    - — Takes into account the requirements of the AICPA, state boards of accountancy, and other regulatory agencies in establishing the firm's CPE requirements
    - — Provides CPE course materials to, and maintains records of completed CPE for, professional personnel
    - — Provides an orientation and training program for new hires
- Encouraging participation by personnel at each level in the firm in other professional development activities such as completing external professional development programs, including graduate-level and self-study courses, becoming members of professional organizations, serving on professional committees, writing for professional publications, and speaking to professional groups

- Communicating and distributing to personnel, when applicable, changes in accounting, auditing, attestation, and quality control standards, as well as independence requirements and the firm's guidance with respect to those standards and requirements

3.32 *Policy 7: Personnel selected for advancement have the qualifications to fulfill the responsibilities they will be called on to assume.* Singleoffice CPA Firm implements this policy through the following procedures:

- Assigning responsibility to the three partners to jointly make advancement and termination decisions. Such responsibilities include the following:
  - — Establishing criteria for evaluating personnel at each professional level and for advancement to the next higher level of responsibility. Such criteria give recognition and reward to the development and maintenance of competence and commitment to ethical principles.
  - — Informing firm personnel about the criteria for advancement to the next higher level of responsibility.
  - — Designating personnel responsible for preparing evaluations and determining when they should be prepared.
  - — Informing personnel that failure to adhere to the firm's policies and procedures regarding performance quality and commitment to ethical principles may result in disciplinary action.
  - — Using forms that include the applicable qualifications when evaluating the performance of personnel. Such forms include qualifications related to performance quality and adherence to ethical principles.
  - — Reviewing evaluations on a timely basis with the individual being evaluated.
- Counseling personnel regarding their progress and career opportunities by doing the following:
  - — Evaluating employees annually and at the end of each assignment lasting four weeks or longer to provide feedback on performance.
  - — Summarizing and reviewing with personnel annually the evaluation of their performance, including an assessment of their progress with the firm. Considerations include past performance, future objectives of the individual and the firm, the individual's assignment preferences, and career opportunities.
  - — Evaluating partners periodically by means of counseling, peer evaluation, or self-appraisal, as appropriate.

Engagement Performance

3.33 The purpose of the engagement performance element of quality control is to provide the firm with reasonable assurance (*a*) that engagements are consistently performed in accordance with applicable professional standards and regulatory and legal requirements and (*b*) that the firm or the engagement part-

ner issues reports that are appropriate in the circumstances. Policies and procedures for engagement performance should address all phases of the design and execution of the engagement, including engagement performance, supervision responsibilities, and review responsibilities. Policies and procedures also should require that consultation takes place when appropriate. In addition, a policy should establish criteria against which all engagements are to be evaluated to determine whether an engagement quality control review should be performed. Singleoffice CPA Firm obtains this assurance by establishing and maintaining the policies and procedures described in paragraphs 3.34–.44.

3.34 *Policy 1: Planning for engagements meets professional, regulatory, and the firm's requirements.* Singleoffice CPA Firm implements this policy by maintaining and providing personnel with the firm's practice aids that prescribe the factors the engagement team should consider in the planning process and the extent of documentation of those considerations. Planning considerations may vary depending on the size and complexity of the engagement. Planning generally includes the following activities:

- Assigning responsibilities to appropriate personnel during the planning phase
- Developing or updating background information on the client and the engagement
- Considering client significance to the firm
- Developing a planning document that includes the following:
  - — Proposed work programs tailored to the specific engagement
  - — Staffing requirements and the need for specialized knowledge
  - — Consideration of the economic conditions affecting the client and its industry and their potential effect on the conduct of the engagement
  - — The risks, including fraud considerations, affecting the client and the engagement and how the risks may affect the procedures performed
  - — A budget that allocates sufficient time for the engagement to be performed in accordance with professional standards and the firm's quality control policies and procedures

3.35 *Policy 2: The engagement is performed, supervised, documented, and reported (or communicated) in accordance with the requirements of professional standards, applicable regulators, and the firm.* Singleoffice CPA Firm implements this policy through the following procedures:

- Providing adequate supervision during the course of an engagement, including briefing the engagement team on the objectives of their work. The training, ability, and experience of the personnel are considered when assigning supervisors to the engagement.
- Requiring that a written work program be used in all engagements.
- Addressing significant issues arising during the engagement, considering their significance, and appropriately modifying the planned approach.
- Adhering to the guidelines set forth by the firm for the form and content of documentation of the work performed and conclusions reached. Such documentation includes standardized forms,

checklists, and questionnaires used in the performance of engagements and explanations, when required, of how the firm integrates such aids into engagements.

- Requiring engagement documentation in accordance with professional standards, applicable regulatory requirements, and the firm's policies.

3.36 *Policy 3: Qualified engagement team members review work performed by other team members on a timely basis.* Singleoffice CPA Firm implements this policy by adhering to the following guidelines established by the firm regarding review of the documentation of the work performed and conclusions reached, the financial statements and reports, and documentation of the review process:

- All reviewers are to have appropriate experience, competence, and responsibility.
- For each engagement, there is to be evidence of appropriate review of documentation of the work performed and conclusions reached, the financial statements, and the report.
- Engagement documentation is reviewed to determine whether the following have occurred:
  - — The work has been performed in accordance with professional standards and regulatory and legal requirements.
  - — Significant findings and issues have been raised for further consideration.
  - — Appropriate consultations have taken place, and the resulting conclusions have been documented and implemented.
  - — The nature, timing, and extent of work performed are appropriate and do not need revision.
  - — The work performed supports the conclusions reached and is appropriately documented.
  - — The evidence obtained is sufficient and appropriate to support the report.
  - — The objectives of the engagement procedures have been achieved.

3.37 *Policy 4: Engagement teams complete the assembly of final engagement files on a timely basis.* Singleoffice CPA Firm implements this policy by completing the assembly of final engagement files in accordance with professional standards and applicable regulatory requirements, if any.

3.38 *Policy 5: The firm maintains the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation.* Singleoffice CPA Firm implements this policy through the following procedures:

- Establishing and applying controls to accomplish the following:
  - — Clearly determine when and by whom engagement documentation was prepared and reviewed.
  - — Protect the integrity of the information at all stages of the engagement, especially when the information is shared within the engagement team or transmitted to other parties via electronic means.

— Prevent unauthorized changes to the engagement documentation.

— Allow access to the engagement documentation by the engagement team and other authorized parties as necessary to properly discharge their responsibilities.

- Implementing procedures for properly distributing engagement documentation materials to engagement teams at the start of the engagement, preparing engagement documentation during the engagement, and assembling final documentation at the end of the engagement.

- Implementing procedures to restrict access to, and enable proper distribution and confidential storage of, hardcopy engagement documentation.

- Requiring the use of passwords by engagement team members and data encryption to restrict access to electronic engagement documentation to authorized users.

- Implementing appropriate back-up routines for electronic engagement documentation at appropriate stages during the engagement.

- Implementing procedures regarding original paper documents that have been electronically scanned or otherwise copied to another media that accomplish the following:

  — Generate copies that contain the entire content of the original paper documentation, including manual signatures, cross-references, and annotations.

  — Integrate the copies into the engagement files, including indexing and signing off on the copies as necessary.

  — Enable the copies to be retrieved and printed as necessary.

3.39 *Policy 6: The firm retains engagement documentation for a period of time sufficient to meet the needs of the firm, professional standards, laws, and regulations.* Singleoffice CPA Firm implements this policy through the following procedures:

- Retaining engagement documentation for a period of time sufficient to meet the requirements of the state board of accountancy and applicable professional standards.

- Establishing procedures that

  — enable the retrieval of, and access to, the engagement documentation during the retention period, particularly in the case of electronic documentation because the underlying technology may be upgraded or changed over time;

  — provide, where necessary, a record of changes made to engagement documentation after the assembly of engagement files has been completed; and

  — enable authorized external parties to access and review specific engagement documentation for quality control or other purposes.

3.40 *Policy 7: The firm requires that consultation take place when appropriate; that sufficient and appropriate resources are available to enable appropriate consultation to take place; that all the relevant facts known to the engagement team are provided to those consulted; that the nature, scope, and conclusions*

of such consultations are documented; and that conclusions resulting from such consultations are implemented. Singleoffice CPA Firm implements this policy through the following procedures:

- Consulting with those having appropriate knowledge, authority, and experience within the firm (or, where applicable, outside the firm) on significant technical, ethical, and other matters. Singleoffice CPA firm uses advisory services provided by other firms, professional and regulatory bodies, and commercial organizations that provide relevant quality control services. Before using such services, the firm evaluates whether the external provider is qualified for that purpose.

- Informing personnel of the firm's consultation policies and procedures.

- Requiring sufficiently experienced engagement team members to identify matters for consultation or consideration during the engagement.

- Requiring consultation in specialized areas or situations with appropriate individuals within and outside the firm when matters such as the following arise:

  — The application of newly issued technical pronouncements.

  — Industries with special accounting, auditing, or reporting requirements, including unusually complex employee benefit plans.

  — Emerging practice problems.

  — Choices among alternative generally accepted accounting principles (GAAP) upon initial adoption or when an accounting change is made.

  — Reissuance of a report, consideration of omitted procedures after a report has been issued, or subsequent discovery of facts that existed at the date a report was issued.

  — Filing requirements of regulators.

  — Meetings with regulators at which the firm is to be called on to support the application of GAAP or generally accepted auditing standards that have been questioned.

- Providing all professional personnel with access to adequate and current reference materials.

- Including all relevant facts, circumstances, the professional literature used, and conclusions reached in the engagement documentation of the work performed and conclusions reached.

- Documenting the issue on which consultation was sought and the results of the consultation, including any decisions taken, the basis for those decisions, and how they were implemented. If there is an unresolved disagreement, an outside source may be consulted to assist in determining the appropriate application of accounting principles.

3.41 *Policy 8: The firm deals with and resolves differences of opinion, documents and implements conclusions reached, and does not release the report until the matter is resolved.* Singleoffice CPA Firm implements this policy through the following procedures:

- Requiring that all differences of professional judgment among members of an engagement team be resolved by the engagement and the quality control partners, and the managing partner if necessary, and that the report not be released until the matter is resolved.

- Requiring that conclusions reached be appropriately documented. If members of the team continues to disagree with the resolution, they may disassociate themselves from the resolution of the matter and may document that a disagreement continues to exist.

3.42 *Policy 9: The firm has criteria for determining whether an engagement quality control review should be performed, evaluates all engagements against the criteria, performs an engagement quality control review for all engagements that meet the criteria, and completes the review before the report is released.* Singleoffice CPA Firm implements this policy through the following procedures:

- Establishing criteria such as the following:

  — The identification of unusual circumstances or risks in an engagement or class of engagements as determined by the engagement partner or quality control partner

  — An engagement quality control review is required by law or regulation

- Evaluating all engagements against the criteria

- Performing an engagement quality control review for all engagements that meet the criteria

3.43 *Policy 10: The firm establishes procedures addressing the nature, timing, extent, and documentation of the engagement quality control review.* Singleoffice CPA Firm implements this policy through the following procedures:

- Implementing procedures addressing the nature, timing, and extent of the review. The firm has concluded that performing an engagement quality control review is not necessary to obtain sufficient appropriate audit evidence for audit engagements; therefore, the engagement quality control review does not need to be completed before the date of the auditor's report. When the engagement quality control review results in additional audit procedures being performed, the date of the auditor's report is changed to the date by which sufficient appropriate audit evidence has been obtained. The firm's procedures require that for audit and attestation engagements, the engagement quality control reviewer do the following:

  — Discuss significant accounting, auditing, and financial reporting issues with the engagement partner, including matters for which there has been consultation.

  — Discuss with the engagement partner the engagement team's identification and audit of high-risk assertions, transactions and account balances.

  — Confirm with the engagement partner that there are no significant unresolved issues.

  — Review selected working papers relating to the significant judgments the engagement team made and the conclusions they reached.

— Review documentation of the resolution of significant accounting, auditing, or financial reporting issues, including documentation of consultation with firm personnel or external sources.

— Review the summary of uncorrected misstatements related to known and likely misstatements.

— Review additional engagement documentation to the extent considered necessary.

— Read the financial statements and the report and consider whether the report is appropriate.

— Complete the review before the release of the report. The review may be conducted at appropriate stages during the engagement.

— Determine whether the issues raised in the review indicate a need to change the auditor's report date.

- Resolving conflicting opinions between the engagement partner and the engagement quality control reviewer regarding significant matters. The policy requires documentation of the resolution of conflicting opinions before the release of the audit report.

- Implementing procedures addressing documentation by the engagement quality control reviewer. The firm's procedures require documentation of the following:

  — The procedures required by the firm's policies on engagement quality control review have been performed.

  — The engagement quality control review has been completed before the report is released.

  — No matters have come to the attention of the engagement quality control reviewer that would cause the reviewer to believe that the significant judgments the engagement team made and the conclusions they reached were not appropriate.

3.44 *Policy 11: The firm establishes criteria for the eligibility of engagement quality control reviewers.* Singleoffice CPA Firm implements this policy by establishing the following criteria for an engagement quality control reviewer:

- Is selected by the quality control partner or the managing partner

- Has sufficient technical expertise and experience

- Carries out his or her responsibilities with objectivity and due professional care without regard to the relative positions of the audit engagement partner and the engagement quality control reviewer

- Meets the independence requirements relating to the engagements reviewed, even though the engagement quality control reviewer is not a member of the engagement team

- Does not make decisions for the engagement team or participate in the performance of the engagement except that the engagement partner may consult the engagement quality control reviewer at any stage during the engagement

When the firm does not have suitably qualified personnel to perform the engagement quality control review, the firm contracts with a suitably qualified external person to perform the engagement quality control review.

Monitoring

3.45 The purpose of the monitoring element of a system of quality control is to provide the firm and its engagement partners with reasonable assurance that the policies and procedures related to the system of quality control are relevant, adequate, operating effectively, and complied with in practice. Monitoring involves an ongoing consideration and evaluation of the appropriateness of the design, the effectiveness of the operation of a firm's quality control system, and a firm's compliance with its quality control policies and procedures. The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of the following:

- Adherence to professional standards and regulatory and legal requirements
- Whether the quality control system has been appropriately designed and effectively implemented
- Whether the firm's quality control policies and procedures have been operating effectively so that reports that are issued by the firm are appropriate in the circumstances

3.46 Singleoffice CPA Firm obtains this assurance by establishing and maintaining the policies and procedures described in paragraphs 3.47–.56.

3.47 *Policy 1: The firm assigns responsibility for the monitoring process, including performance, to a partner or competent individual.* Singleoffice CPA Firm implements this policy through the following procedures:

- Designating a partner or senior personnel to be responsible for quality assurance, including ensuring that the firm's quality control policies and procedures and its methodologies remain relevant and adequate. Factors to be considered include the following:
  - — Mergers and divestitures of portions of the practice.
  - — Changes in professional standards or other regulatory requirements applicable to the firm's practice.
  - — Results of inspections and peer reviews.
  - — Review of litigation and regulatory enforcement actions against the firm and its personnel.
  - — Changes in applicable AICPA membership requirements.
- Determining whether personnel have been appropriately informed of their responsibilities for maintaining the firm's standards of quality in performing their duties.

- Identifying the need to do the following:

  — Revise policies and procedures related to the other elements of quality control because they are ineffective or inappropriately designed.

  — Improve compliance with firm policies and procedures related to the other elements of quality control.

3.48 *Policy 2: The firm performs monitoring procedures that are sufficiently comprehensive to enable the firm to assess compliance with all applicable professional standards and the firm's quality control policies and procedures.*

3.49 For purposes of illustrating Policy 2, two scenarios are described. Scenario 1 illustrates how Singleoffice CPA Firm would satisfy the objective of Policy 2 by reviewing engagements throughout the year. Scenario 2 illustrates how Singleoffice CPA Firm would implement Policy 2 by performing an annual inspection, thereby reviewing engagements during a designated period in the year.

3.50 *Scenario 1: Monitoring by Reviewing Engagements Throughout the Year.* Singleoffice CPA Firm implements Policy 2 through the following procedures:

- Designating a partner or management-level individual not previously associated with the engagement to perform either a preissuance or postissuance review of the engagement.

- Establishing the approach for performing preissuance or postissuance reviews, for example, the comprehensiveness of the review and the frequency for summarizing findings (such as monthly or quarterly). The comprehensiveness of the review of selected engagements is similar to that performed in an inspection or peer review.

- Designating the forms and checklists to be used during the engagement and functional element reviews and the extent of the documentation required. (Examples of functional elements are the human resources function and the firm's library.)

- Selecting a cross-section of engagements at the beginning of the monitoring year for preissuance or postissuance review and reevaluating that selection throughout the year as circumstances dictate. Criteria used for selecting engagements include the following:

  — Significant specialized industries with emphasis on high-risk engagements.

  — Audits of the financial statements of employee benefit plans.

  — First-year engagements.

  — Significant client engagements.

  — Level of service performed (that is, audit and attest, review, or compilation).

  — Engagements performed by all partners and other management-level personnel having accounting and auditing responsibilities.

  — Engagements performed under *Government Auditing Standards* (Yellow Book engagements).

— Engagements for which there have been complaints or allegations from firm personnel, clients, or other third parties that the work performed by the firm failed to comply with professional standards, regulatory requirements, or the firm's system of quality control.

— Engagements in which there were significant disagreements between the review partner and the engagement partner.

- Reviewing the selected engagements. Deficiencies identified as a result of this process are summarized and evaluated to determine whether the following are necessary:

  — Additional emphasis on specific areas or industries in future engagements.

  — Modifications to existing policies and procedures to prevent the deficiencies noted from recurring.

- Reviewing other engagement files at least annually for compliance with the firm's quality control policies and procedures including reviewing correspondence regarding consultation on independence, integrity, and objectivity matters (for example, assessments of significant clients) and acceptance and continuance decisions.

- Reviewing the resolution of matters reported by professional personnel regarding independence to determine that matters have been appropriately considered and resolved.

- Preparing a summary of the deficiencies noted resulting from the preissuance and postissuance reviews so that the partner may incorporate any recommended changes into the firm's policies and procedures.

- Communicating to all professional personnel the deficiencies noted and related changes in quality control procedures.

- Following up on planned corrective actions to determine whether the actions were taken as planned and whether they achieved the intended objectives.

3.51 *Scenario 2: Monitoring by Inspecting a Sample of Engagements During a Designated Period of the Year.* Singleoffice CPA Firm implements Policy 2 through the following procedures:

- Designating a partner to be responsible for performing an annual inspection using guidance prepared by the AICPA for performing inspection procedures. These procedures include reviewing a cross-section of engagements using the following criteria in selecting engagements:

  — Significant specialized industries with emphasis on high-risk engagements.

  — Audits of the financial statements of employee benefit plans.

  — First-year engagements.

  — Significant client engagements.

  — Level of service performed (that is, audit and attest, review, or compilation).

— Engagements performed by all partners and other management-level personnel having accounting and auditing responsibilities.

— Engagements performed under *Government Auditing Standards* (Yellow Book engagements).

— Engagements for which there have been complaints or allegations from firm personnel, clients, or other third parties that the work performed by the firm failed to comply with professional standards, regulatory requirements, or the firm's system of quality control.

— Engagements in which there were significant disagreements between the quality review partner and the engagement partner.

- Establishing an approach and timetable for performing the inspection procedures and determining the forms and checklists to be used during the inspection and the extent of documentation required.

- Deciding how long to retain detailed inspection documentation (as opposed to summaries).

- Reviewing correspondence regarding consultation on independence, integrity, and objectivity matters and acceptance and continuance decisions.

- Reviewing the resolution of matters reported by professional personnel regarding independence to determine that matters have been appropriately considered and resolved.

- Selecting a sample of engagements for review to determine compliance with the firm's quality control policies and procedures, reevaluating that selection throughout the process, and reviewing the selected engagements.

- Preparing a summary inspection report for the partner or management group that evaluates the overall results of the inspection and sets forth any recommended changes that should be made to the firm's policies and procedures.

- Reviewing the recommended corrective actions and reaching final conclusions about the actions to be taken.

- Communicating inspection findings and quality control changes to all professional personnel.

- Following up on planned corrective actions to determine whether those actions were taken and whether they achieved the intended objective(s).

3.52 In addition to the procedures described under Scenarios 1 or 2, Singleoffice CPA Firm also implements Policy 2 through the following procedures:

- Reviewing and evaluating firm practice aids, such as audit programs, forms, and checklists, and considering whether they reflect recent professional pronouncements

- Providing information during staff meetings regarding new professional standards, regulatory requirements, and the related changes that should be made to firm practice aids

- Reviewing, or designating a management-level individual to be responsible for reviewing, the professional development policies and procedures to determine whether they are appropriate, effective, and meet the needs of the firm

- Reviewing, or designating a management-level individual to review summaries of the CPE records of the firm's professional personnel to evaluate each individual's compliance with the requirements of the AICPA and other applicable regulators

- Reviewing other administrative and personnel records pertaining to the quality control elements

- Soliciting information from the firm's personnel during staff meetings regarding the effectiveness of training programs

3.53 *Policy 3: The firm communicates (a) deficiencies noted as a result of the monitoring process and recommendations for appropriate remedial action to relevant engagement partners and other appropriate personnel and (b) the results of the monitoring of its quality control system process to relevant firm personnel at least annually.* Singleoffice CPA Firm implements this policy through the following procedures:

- Preparing a summary report for the partners that evaluates the overall results of the monitoring and sets forth any recommended changes that should be made to the firm's policies and procedures

- Reviewing the recommended corrective actions and reaching final conclusions regarding the actions to be taken

- Communicating to all professional personnel the deficiencies noted and the related changes in quality control procedures

- Following up on planned corrective actions to determine whether those actions were taken and whether they achieved the intended objective(s)

3.54 *Policy 4: The firm deals appropriately with complaints and allegations.* Singleoffice CPA Firm implements this policy through the following procedures:

- Having the managing partner inform personnel that they may raise any concerns regarding complaints or allegations about noncompliance with professional standards, regulatory and legal requirements, or the firm's system of quality control with any partner without fear of reprisals.

- Having a partner who is not otherwise involved in the engagement investigate the following:

  — Complaints and allegations that the work performed by the firm fails to comply with professional standards and regulatory and legal requirements.

  — Allegations of noncompliance with the firm's system of quality control.

  — Deficiencies in the design or operation of the firm's quality control policies and procedures, or noncompliance with the firm's system of quality control by an individual or individuals, as identified during the investigations into complaints and allegations.

- Documenting complaints and allegations and the responses to them.

3.55 *Policy 5: The firm prepares appropriate documentation to provide evidence of the operation of each element of its system of quality control.* Singleoffice CPA Firm implements this policy by designing its summary monitoring report to provide evidence of the operation of each element of its system of quality control, including the following:

- Monitoring procedures, including the procedure for selecting completed engagements to be inspected
- A record of the evaluation of the following:
  - — Adherence to professional standards and regulatory and legal requirements
  - — Whether the quality control system has been appropriately designed and effectively implemented
  - — Whether the firm's quality control policies and procedures have been appropriately applied so that reports that are issued by the firm or engagement partners are appropriate in the circumstances
- Identification of the deficiencies noted, an evaluation of their effects, and the basis for determining whether further action is necessary and what that action should be

3.56 *Policy 6: The firm retains documentation providing evidence of the operation of the system of quality control for an appropriate period of time*. Singleoffice CPA Firm implements this policy by requiring retention of the summary monitoring report for a period of time sufficient to meet the firm's peer review or other regulatory requirements.

Chapter 4

System of Quality Control for a CPA Firm's Accounting Practice — Sole Practitioner

4.01 This chapter describes how a sole practitioner (Sole Practitioner, CPA) implements each element of quality control in her accounting practice. Sole Practitioner, CPA, is a hypothetical firm of which Sole Practitioner, CPA, is the sole owner. The firm has no professional staff; however, on occasion Sole Practitioner, CPA, hires per diem professionals. Her accounting practice consists only of engagements subject to Statements on Standards for Accounting and Review Services (SSARSs). She uses practice aids that have been subjected to peer review in accordance with standards established by the AICPA. Sole Practitioner, CPA, uses per diem personnel to assist her and recognizes that her policies and procedures would have to change if she were to perform audit or attest engagements or hire full-time or part-time professional staff.

Quality Control Policies and Procedures

4.02 The firm's system of quality control consists of policies designed to achieve the objectives of the system and the procedures necessary to implement and monitor compliance with those policies. The policies and procedures are required to be documented. Sole Practitioner, CPA, documents her system of quality control by filling out checklists and questionnaires such as those included in the AICPA Peer Review Program Manual. Sole Practitioner, CPA, reviews the documentation at least annually and updates it as necessary.

4.03 The firm should communicate its quality control policies and procedures to its personnel. Effective communication includes the following:

- A description of quality control policies and procedures and the objectives they are designed to achieve
- The message that each individual has a personal responsibility for quality

4.04 Sole Practitioner, CPA, meets this requirement with regard to herself by annually reviewing the checklists and questionnaires used to document each element of her system of quality control. Sole Practitioner, CPA, communicates her policies and procedures to per diem professionals when they are initially contracted for an engagement by holding a discussion with them and follows up on individual engagements. Sole Practitioner, CPA, requires per diem personnel to be familiar with and to comply with these policies and procedures.

Leadership Responsibilities for Quality Within the Firm (the "Tone at the Top")

4.05 The purpose of the leadership responsibilities element of a system of quality control is to promote an internal culture based on the recognition that quality is essential in performing engagements. Sole Practitioner, CPA, satisfies this purpose by establishing and maintaining the policies and procedures described in paragraphs 4.06–.08.

4.06 *Policy 1: I am ultimately responsible for the firm's system of quality control.* Sole Practitioner, CPA, implements this policy through the following procedures:

- Accepting responsibility for the firm's system of quality control
- Educating herself about requirements for a system of quality control
- Designing and implementing policies and procedures required for her firm's system of quality control

4.07 *Policy 2: Commercial considerations do not override the quality of the work performed.* Sole Practitioner, CPA, implements this policy by continually evaluating client relationships and specific engagements so that commercial considerations do not override the objectives of the system of quality control.

4.08 *Policy 3: I devote sufficient and appropriate resources for the development, communication, and support of the firm's quality control policies and procedures.* Sole Practitioner, CPA, implements this policy by reviewing and updating the quality control policies, procedures, and documentation on an annual basis.

Relevant Ethical Requirements

4.09 The purpose of the relevant ethical requirements element of a system of quality control is to provide the firm with reasonable assurance that the firm and its personnel comply with relevant ethical requirements when discharging professional responsibilities. Relevant ethical requirements include independence, integrity, and objectivity. Sole Practitioner, CPA, obtains this assurance by establishing and maintaining the policies and procedures described in paragraphs 4.10–.13.

4.10 *Policy 1: I adhere to relevant ethical requirements such as those in regulations, interpretations, and rules of the AICPA, state CPA societies, state boards of accountancy, state statutes, the U.S. Government Accountability Office, and any other applicable regulators.* Sole Practitioner, CPA, implements this policy through the following procedures:

- Subscribing to the AICPA *Professional Standards* service.
- Consulting the AICPA website for information about changes in professional ethics and independence standards.
- Reviewing unpaid client fees to ascertain whether any outstanding amounts impair the firm's independence.
- Reviewing relevant pronouncements published in the *Journal of Accountancy* relating to independence, integrity, and objectivity and retaining relevant issues of the *Journal of Accountancy*.
- Attending periodic professional training in ethics and independence.
- Complying with SSARSs by disclosing in the accountant's compilation report instances in which the firm is not independent.
- Considering the significance of each client to the firm. In broad terms, the significance of a client to a firm refers to relationships that could diminish a practitioner's objectivity and independence in performing attest services. In determining the significance of a client, the firm considers (*a*) the amount of time the partner devotes to the engagement and (*b*) the effect that losing the client would have on the firm.

4.11 *Policy 2: I communicate independence requirements to per diem professionals.* Sole Practitioner, CPA, implements this policy by making per diem personnel aware of financial, family, business, and other relationships that may be prohibited by applicable requirements.

4.12 *Policy 3: I establish procedures to identify and evaluate possible threats to independence and objectivity and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards. I withdraw from the engagement if effective safeguards to reduce threats to independence to an acceptable level cannot be applied.* Sole Practitioner, CPA, implements this policy through the following procedures:

- Considering relevant information about client engagements, including the scope of services, to enable her to evaluate the overall impact on independence.
- Consulting with AICPA Ethics Hotline with concerns about possible threats to independence.
- Accumulating and communicating relevant information to per diem personnel as appropriate so that the following can occur:
  - — Sole Practitioner, CPA, and per diem personnel can readily determine whether they satisfy independence requirements.
  - — Sole Practitioner, CPA, can maintain and update information relating to independence.
  - — Sole Practitioner, CPA, can take appropriate action regarding identified threats to independence.
- Requiring per diem personnel to promptly notify her of independence breaches of which they become aware, and circumstances and relationships that create a threat to independence, so that appropriate action can be taken.
- Documenting any safeguards applied to eliminate threats to independence or reduce them to an acceptable level.
- Withdrawing from the engagement if effective safeguards to reduce threats to independence to an acceptable level cannot be applied.

4.13 *Policy 4: I confirm, in writing, my compliance with policies and procedures on independence and require written confirmation from all per diem professionals required to be independent by relevant requirements.* Sole Practitioner, CPA, implements this policy by signing a step on each engagement program attesting to her independence and requiring per diem personnel to do the same.

Acceptance and Continuance of Client Relationships and Specific Engagements

4.14 The purpose of the quality control element that addresses acceptance and continuance of client relationships and specific engagements is to establish criteria for deciding whether to accept or continue a client relationship and whether to perform a specific engagement for a client. A firm's client acceptance and continuance policies represent a key element in mitigating litigation and business risk. Accordingly, it is important that a firm be aware that the integrity and reputation of a client's management could reflect the reliability of the client's accounting records and financial representations and, therefore, affect the firm's reputation or involvement in litigation. A firm's policies and procedures related to the acceptance

and continuance of client relationships and specific engagements should provide the firm with reasonable assurance that it will undertake or continue relationships and engagements only where it

- is competent to perform the engagement and has the capabilities and resources to do so;
- can comply with legal and ethical requirements;
- has considered the client's integrity and does not have information that would lead it to conclude that the client lacks integrity; and
- has reached an understanding with the client regarding the services to be performed.

4.15 Sole Practitioner, CPA, obtains this assurance, both with respect to the initial period for which the firm is performing its service and for subsequent periods, by establishing and maintaining the policies and procedures described in paragraphs 4.16–.20.

4.16 *Policy 1: I evaluate factors that have a bearing on management's integrity and consider the risk associated with providing professional services in particular circumstances.* Sole Practitioner, CPA, implements this policy through the following procedures:

- Obtaining information such as the following before accepting or continuing a client:
  - — The nature and purpose of the services to be provided.
  - — The identity of the client's principal owners, key management, related parties, and those charged with its governance.
  - — The nature of the client's operations, including its business practices, from sources such as prior-year reports, internally generated financial statements (if applicable), income tax returns, and credit reports.
  - — Information concerning the attitude of the client's principal owners, key management, and those charged with its governance toward such matters as aggressive interpretation of accounting standards and internal control over financial reporting.
- Inquiring of third parties such as bankers, factors, and legal counsel about management's business reputation and integrity.
- Evaluating the information obtained regarding management's integrity.
- Evaluating the risk of providing review services to significant clients or to other clients for which Sole Practitioner's, CPA, objectivity or the appearance of independence may be impaired. In determining the significance of a client, Sole Practitioner, CPA, considers the amount of time she devotes to the engagement and the effect that losing the client would have on her practice.

4.17 *Policy 2: I evaluate whether the engagement can be completed with professional competence; undertake only those engagements for which the firm has the capabilities, resources, and professional competence to complete; and evaluate, at the end of specific periods or upon occurrence of certain events, whether the relationship should be continued.* Sole Practitioner, CPA, implements this policy through the following procedures:

- Establishing a cut-off date by which evaluations of engagements should be performed, for example, before work on the current-year engagement begins.

- Considering conditions, such as the following, that require reevaluation of a client or specific engagement and obtaining the relevant information to determine whether the relationship should be continued:

  — Significant changes in the client, for example, a major change in ownership, senior client personnel, directors, advisers, the nature of the business, or the financial stability of the client.

  — Changes in the nature or scope of the engagement, including requests for additional services.

  — Client significance.

  — Matters that would have caused the firm to reject the client or engagement had such conditions existed at the time of the initial acceptance. If such matters exist, Sole Practitioner, CPA, considers the professional and legal responsibilities that apply to the circumstances and the possibility of withdrawing from the engagement or both the engagement and the client relationship.

  — The client's delinquency in paying fees. (This also may affect the firm's independence.)

- Determining if she has, or can reasonably obtain, the knowledge and expertise to perform the engagement.

- Evaluating the information obtained regarding the engagement, making the acceptance or continuance decision, and documenting her evaluation or conclusion in a memorandum or by signing off next to the relevant item in a practice aid.

4.18 *Policy 3: I obtain an understanding with the client regarding the services to be performed.* Sole Practitioner, CPA, implements this policy through the following procedures:

- Adhering to all requirements set forth in professional standards regarding agreeing upon the terms of the engagement with the client

- Requiring that the agreed upon terms of the engagement be documented in an engagement letter or other suitable form of written agreement and be signed by both (*a*) the accountant or the accountant's firm and (*b*) management or those charged with governance, as appropriate

4.19 *Policy 4: I follow established procedures on withdrawal from an engagement or from both the engagement and the client relationship.* Sole Practitioner, CPA, implements this policy by discussing the issues and her conclusion with the appropriate level of the client's management and those charged with its governance. If she considers it necessary, she also discusses her decision with her attorney.

4.20 *Policy 5: I document how issues relating to acceptance or continuance of client relationships and specific engagements were resolved.* Sole Practitioner, CPA, implements this policy by documenting, in a memorandum to the engagement files, significant issues, consultations, conclusions, and the basis for the conclusions relating to acceptance or continuance of client relationships and specific engagements.

Human Resources

4.21 The purpose of the human resources element of a system of quality control is to provide the firm with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary (*a*) to perform its engagements in accordance with professional standards and regulatory and legal requirements and (*b*) to enable the firm to issue reports that are appropriate in the circumstances. Sole Practitioner, CPA, obtains this assurance by establishing and maintaining the policies and procedures described in paragraphs 4.22–.23.

4.22 *Policy 1: I hire per diem personnel of integrity who possess the characteristics that enable them to perform competently.* Sole Practitioner, CPA, implements this policy by setting criteria, regarding such factors as education, certification or licensure, and experience, which per diem personnel must meet to be hired.

4.23 *Policy 2: I maintain the knowledge, skills, and abilities required in the circumstances by participating in general and industry-specific continuing professional education (CPE) and professional development activities that enable me to accomplish my responsibilities and satisfy applicable CPE requirements of the AICPA, state CPA societies, state boards of accountancy, and other applicable regulators. I also monitor the compliance of per diem employees with CPE requirements.* Sole Practitioner, CPA, implements this policy through the following procedures:

- Maintaining the competencies necessary to accomplish responsibilities related to each of the firm's engagements
- Establishing a professional development program that takes into account the requirements of the AICPA and state boards of accountancy
- Participating in external professional development programs, including graduate-level and self-study courses
- Joining and becoming an active member of professional organizations
- Serving on professional committees, writing for professional publications on topics she is knowledgeable about, and participating in other professional activities
- Considering changes in the applicable professional standards when determining her professional development program
- Setting criteria that per diem personnel must meet to competently perform engagements, such as the following examples:
    - — Determining that per diem personnel are in compliance with the applicable professional education requirements of the AICPA, state boards of accountancy, and state CPA societies
    - — Obtaining and retaining documentation of such compliance
- Evaluating the knowledge and expertise required to perform an engagement prior to accepting the client or engagement

- Reading professional publications, such as state society journals, to keep abreast of changes in accounting standards and any industry-specific pronouncements that affect the client

- Consulting the AICPA website for information about changes in professional standards

Engagement Performance

4.24 The purpose of the engagement performance element of quality control is to provide the firm with reasonable assurance (*a*) that engagements are consistently performed in accordance with applicable professional standards and regulatory and legal requirements and (*b*) that the firm or the practitioner-in-charge issues reports that are appropriate in the circumstances. Policies and procedures for engagement performance should address all phases of the design and execution of the engagement, including engagement performance, supervision responsibilities, and review responsibilities. Policies and procedures also should require that consultation takes place when appropriate. In addition, a policy should establish criteria against which all engagements are to be evaluated to determine whether an engagement quality control review should be performed. Sole Practitioner, CPA, obtains this assurance by establishing and maintaining the policies and procedures described in paragraphs 4.25–.32.

4.25 *Policy 1: I plan engagements to meet professional standards, regulatory requirements, and the firm's requirements.* Sole Practitioner, CPA, implements this policy by adhering to professional standards regarding the planning process and the extent of documentation of the planning, if applicable. Engagement planning considerations may include the following:

- Developing or updating client information.

- Assessing the significance of the client to her firm.

- Obtaining an engagement letter signed by both (*a*) the accountant or the accountant's firm and (*b*) management or those charged with governance, as appropriate for engagements performed in accordance with SSARSs.

- Reviewing prior financial statements and accountants' reports, if applicable.

- Using work programs and applicable reporting and disclosure checklists.

4.26 *Policy 2: I perform, supervise, review, document, and report (or communicate) in accordance with the requirements of professional standards.* Sole Practitioner, CPA, implements this policy through the following procedures:

- Requiring the use of appropriate practice aids in all engagements

- Maintaining the availability of current practice aids and AICPA professional standards

- Briefing per diem personnel on the engagement so that they understand the objectives of their work

- Documenting the work performed in accordance with professional standards and the firm's policy

- Supervising per diem personnel as appropriate based on the following:

— Understanding of, and practical experience with, engagements of a similar nature and complexity through appropriate training and participation

— Understanding of professional standards and regulatory and legal requirements

— Technical knowledge, including knowledge of relevant information technology

— Knowledge of relevant industries in which the client operates

— Ability to apply professional judgment

— Understanding of the firm's quality control policies and procedures

— Experience level

- Reviewing and initialing all engagement documentation prepared by per diem personnel

4.27 *Policy 3: I complete the assembly of final engagement files on a timely basis.* Sole Practitioner, CPA, implements this policy by completing the assembly of final engagement files on a timely basis in accordance with professional standards and applicable regulatory requirements, if any.

4.28 *Policy 4: I maintain the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation.* Sole Practitioner, CPA, implements this policy through the following procedures:

- Establishing and applying controls to do the following:

  — Clearly determine when and by whom engagement documentation was prepared and reviewed.

  — Protect the integrity of the information at all stages of the engagement.

  — Prevent unauthorized changes to the engagement documentation.

  — Allow access to the engagement documentation by per diem personnel and other authorized parties as necessary to properly discharge their responsibilities.

- Tracking the distribution of engagement documentation materials to the per diem personnel at the start of the engagement, preparing engagement documentation during the engagement, and assembling final documentation at the end of the engagement.

- Restricting access to, and enabling proper distribution and confidential storage of, hardcopy engagement documentation.

- Using passwords or data encryption, or both, to restrict access to electronic engagement documentation to authorized users.

- Using appropriate back-up routines for electronic engagement documentation at appropriate stages during the engagement.

- Implementing procedures regarding original paper documents that have been electronically scanned or otherwise copied to another media that accomplish the following:

  — Generate copies that contain the entire content of the original paper documentation, including manual signatures, cross-references, and annotations.

  — Integrate the copies into the engagement files, including indexing and signing off on the copies as necessary.

  — Enable the copies to be retrieved and printed as necessary.

4.29 *Policy 5: I retain engagement documentation for a period of time sufficient to meet the needs of the firm, professional standards, laws, and regulations.* Sole Practitioner, CPA, implements this policy through the following procedures:

- Retaining engagement documentation for a period of time sufficient to meet the requirements of the state board of accountancy and applicable professional standards

- Enabling the retrieval of, and access to, the engagement documentation during the retention period, particularly in the case of electronic documentation because the underlying technology may be upgraded or changed over time

- Providing, where necessary, a record of changes made to engagement documentation after the assembly of engagement files has been completed

- Enabling authorized external parties to access and review specific engagement documentation for quality control or other purposes

4.30 *Policy 6: I require that consultation take place when appropriate; I make sufficient and appropriate resources available to enable appropriate consultation to take place; I provide to those consulted all the relevant facts known to me; I document the nature, scope, and conclusions of such consultations; and I implement conclusions resulting from such consultations.* Sole Practitioner, CPA, implements this policy through the following procedures:

- Maintaining current technical references to assist in resolving practice problems.

- Referring to the AICPA's Technical Hotline or other qualified individuals if a practice problem arises for which the firm needs additional expertise.

- Requiring that documentation of consultation include the following:

  — All relevant facts and circumstances about the issue on which consultation was sought.

  — References to professional literature used in the analysis of the matter.

  — The results of the consultation, including any decisions made, the basis for those decisions, and how they were implemented. This documentation is retained with the engagement documentation.

4.31 *Policy 7: I deal with and resolve differences of opinion; I document and implement the conclusions reached; and I do not release the report (or the financial statements in an engagement to prepare finan-*

cial statements) until the matter is resolved. Sole Practitioner, CPA, implements this policy by (*a*) evaluating issues of professional judgment when differences of opinion arise with per diem personnel, with those consulted, or with an external reviewer and (*b*) resolving the matter before releasing the report (or the financial statements). If persons involved in the engagement continue to disagree with the resolution, they may disassociate themselves from the resolution of the matter and document that a disagreement continues to exist.

4.32 *Policy 8: I have criteria for determining whether an engagement quality control review should be performed; I evaluate all engagements against the criteria before I accept the engagement; I contract with a qualified external person to perform the engagement quality control review; and I do not release the report (or the financial statements) until the review is completed.* Sole Practitioner, CPA, implements this policy through the following procedures:

- Establishing the following criteria for determining whether an engagement quality control review should be performed:
  - — The engagement is subject to Statements on Auditing Standards or Statements on Standards for Attestation Engagements.
  - — An initial engagement for a client is in a specialized industry in which Sole Practitioner, CPA, has had no previous experience.
  - — An engagement quality control review is required by law or regulation.
- Evaluating all engagements against the criteria.
- Contracting with a qualified external person to perform the engagement quality control review.
- Not releasing the report (or the financial statements) until the review is completed.

Monitoring

4.33 The purpose of the monitoring element of a system of quality control is to provide the firm with reasonable assurance that the policies and procedures related to the system of quality control are relevant, adequate, operating effectively, and complied with in practice. Monitoring involves an ongoing consideration and evaluation of the appropriateness of the design, the effectiveness of the operation of a firm's quality control system, and a firm's compliance with its quality control policies and procedures. The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of the following:

- Adherence to professional standards and regulatory and legal requirements
- Whether the quality control system has been appropriately designed and effectively implemented
- Whether the firm's quality control policies and procedures have been operating effectively so that reports that are issued by the firm are appropriate in the circumstances

4.34 Sole Practitioner, CPA, obtains this assurance by establishing and maintaining the policies and procedures described in paragraphs 4.35–.39.

4.35 *Policy 1: I perform monitoring procedures that are sufficiently comprehensive to enable me to assess compliance with all applicable professional standards and the firm's quality control policies and procedures.* Sole Practitioner, CPA, implements this policy through the following procedures:

- Performing a postissuance review of selected engagements at least annually [fn 1]
- Summarizing the findings from the firm's monitoring procedures at least annually and considering the systemic causes of findings that indicate improvements are needed
- Determining any corrective actions or improvements to be made with respect to the specific engagements reviewed or the firm's quality control policies and procedures and taking those actions, including necessary modifications to the quality control system, on a timely basis
- Reviewing compliance with the firm's policies and procedures related to relevant ethical responsibilities, including independence, human resources, acceptance and continuance of client relationships and specific engagements, and engagement performance
- Reviewing all policies and procedures and revising those affected by changes in professional standards or the nature of her practice
- Reviewing and determining that the firm's practice aids are current and reflect recent professional pronouncements and changes in her practice
- Reviewing CPE records to determine whether the classroom training and self-study programs she uses are appropriate for the firm's practice
- Reviewing CPE records to determine compliance with the requirements of the AICPA and other applicable regulatory agencies

4.36 *Policy 2: I deal appropriately with complaints and allegations.* Sole Practitioner, CPA, implements this policy through the following procedures:

- Investigating the following:
  - — Complaints and allegations that the work performed by the firm fails to comply with professional standards and regulatory and legal requirements
  - — Allegations of noncompliance with the firm's system of quality control
  - — Deficiencies in the design or operation of the firm's quality control policies and procedures, or noncompliance with the firm's system of quality control by an individual or individuals, as identified during the investigations into complaints and allegations

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[fn 1] A postissuance review may be performed as part of an inspection. A sole proprietor may consider engaging another CPA to perform the inspection to obtain a fresh look at the engagement. See paragraph 3.52 for a description of how a firm considers and evaluates, on an ongoing basis, compliance with a firm's policies and procedures by performing an annual inspection. Note that a preissuance review by the sole proprietor does not satisfy the monitoring requirements.

- Documenting complaints and allegations and the responses to them

4.37 *Policy 3: I prepare appropriate documentation to provide evidence of the operation of each element of the firm's system of quality control.* Sole Practitioner, CPA, implements this policy by documenting evidence of the operation of each element of the firm's system of quality control by preparing a memorandum of the following:

- Monitoring procedures, including the procedure for selecting completed engagements to be subject to postissuance review
- A record of the evaluation of the following:
  - — Adherence to professional standards and regulatory and legal requirements
  - — Whether the quality control system has been appropriately designed and effectively implemented
  - — Whether the firm's quality control policies and procedures have been appropriately applied so that reports that are issued by the firm are appropriate in the circumstances
- Identification of the deficiencies noted, an evaluation of their effects, and the basis for determining whether further action is necessary and what that action should be

4.38 Although the form and content of that documentation is a matter of judgment, the illustration in table 1, "Summary of Quality Control Monitoring For the Calendar Year 20XX," in this chapter is an example of such documentation.

4.39 *Policy 4: I retain documentation of evidence of the operation of the system of quality control for an appropriate period of time.* Sole Practitioner, CPA, implements this policy by requiring retention of the summary report for a period of time sufficient to meet the firm's peer review or other regulatory requirements.

Table 1: Summary of Quality Control Monitoring For the Calendar Year 20XX

Element of Quality Control and Applicable Policies	*Reviewer's Initials and Date Reviewed*	*Location of Additional Documentation*
Leadership Responsibilities for Quality Within the Firm		**These policies are evidenced by the overall operation of the firm's system of quality control.**
Relevant Ethical Requirements		
Policy 1. Adhering to relevant ethical requirements such as those in regulations, interpretations, and rules of the AICPA, state CPA societies, state boards of accountancy, state statutes, and other applicable regulators.	JB 6/30/XX	Independence confirmation files
Policy 2. Communicating independence requirements to per diem professionals and, where applicable, others subject to them.	JB 6/30/XX	Independence confirmation files
Policy 3. Establishing procedures to help mitigate possible threats to my independence and objectivity.	JB 6/30/XX	Independence confirmation files

Element of Quality Control and Applicable Policies	*Reviewer's Initials and Date Reviewed*	*Location of Additional Documentation*
Policy 4. Confirming, in writing, my compliance with policies and procedures on independence and obtaining written confirmation from all per diem professionals required to be independent by relevant requirements.	JB 6/30/XX	Independence confirmation files
Acceptance and Continuance of Client Relationships and Specific Engagements		
Policy 1. Evaluating factors that have a bearing on management's integrity and considering the risk associated with providing professional services in particular circumstances.	JB 6/30/XX	Client acceptance files and client engagement files
Policy 2. Accepting or continuing to perform only those engagements that I can complete with professional competence and evaluating whether the relationship should be continued.	JB 6/30/XX	Engagement files
Policy 3. Obtaining an understanding with the client regarding services to be performed.	JB 6/30/XX	Engagement files
Policy 4. Following established procedures on withdrawal from an engagement or from both the engagement and the client relationship.	JB 6/30/XX	Not applicable for year ended 20XX
Policy 5. Documenting how issues relating to acceptance or continuance of client relationships and specific engagements were resolved.	JB 6/30/XX	Client acceptance files and client engagement files
Human Resources		
Policy 1. Hiring per diem personnel of integrity who possess the characteristics that enable them to perform competently.	JB 6/30/XX	Personnel files
Policy 2. (*a*) Maintaining the knowledge, skills, and abilities required in the circumstances by participating in general and industry-specific continuing professional education (CPE) and professional development activities that enable me to accomplish my responsibilities and satisfy applicable CPE requirements of the AICPA, state CPA society, state boards of accountancy, and other applicable regulators and (*b*) monitoring for compliance the CPE requirements of per diem employees.	JB 6/30/XX	Personnel files
Engagement Performance		
Policy 1. Planning engagements to meet professional standards, regulatory requirements, and the firm's requirements.	JB 6/30/XX	Engagement files
Policy 2. Performing, supervising, reviewing, documenting, and reporting (or communicating) in accordance with the requirements of professional standards.	JB 6/30/XX	Engagement files
Policy 3. Completing the assembly of final engagement files on a timely basis.	JB 6/30/XX	Engagement files
Policy 4. Maintaining the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation.	JB 6/30/XX	Engagement files
Policy 5. Retaining engagement documentation for a period of time sufficient to meet the needs of the firm, professional standards, laws, and regulations.	JB 6/30/XX	Engagement files

Element of Quality Control and Applicable Policies	*Reviewer's Initials and Date Reviewed*	*Location of Additional Documentation*
Policy 6. Requiring that consultation take place when appropriate; making sufficient and appropriate resources available to enable appropriate consultation to take place; providing to those consulted all the relevant facts known to me; documenting the nature, scope, and conclusions of such consultations; and implementing conclusions resulting from such consultations.	JB 6/30/XX	Engagement files
Policy 7. Dealing with and resolving differences of opinion; documenting and implementing the conclusions reached; and not releasing the report until the matter is resolved.	JB 6/30/XX	Engagement files
Policy 8. Evaluating all engagements against my criteria for an engagement quality control review; contracting with a qualified external person to perform the engagement quality control review; and not releasing the report until the review is completed.	JB 6/30/XX	Client acceptance files
Monitoring		
Policy 1. Performing monitoring procedures that are sufficiently comprehensive to enable me to assess compliance with all applicable professional standards and the firm's quality control policies and procedures.	JB 6/30/XX	Monitoring files
Policy 2. Dealing appropriately with complaints and allegations.	JB 6/30/XX	Engagement files
Policy 3. Preparing appropriate documentation to provide evidence of the operation of each element of the firm's system of quality control.	JB 6/30/XX	Monitoring files
Policy 4. Retaining documentation of evidence of the operation of the system of quality control for an appropriate period of time.	JB 6/30/XX	Monitoring files

Chapter 5

System of Quality Control for an Alternative Practice Structure

5.01 An *alternative practice structure*, as referred to in this practice aid, is a nontraditional structure in the practice of public accounting that contains an attest and a nonattest portion. The attest portion is conducted through a firm owned and controlled by CPAs (a *closely aligned CPA firm*). The nonattest portion is conducted through a separate issuer or nonissuer firm owned and controlled by individuals who are not CPAs (a *non-CPA-owned entity* [fn 1]). The non-CPA-owned entity may be an issuer or a nonissuer. Alternative practice structures are described in the "Alternative Practice Structures" interpretation (AICPA, *Professional Standards*, ET sec. 1.220.020) of the "Independence Rule" (AICPA, *Professional Standards*, ET sec. 1.200.001), which is included as appendix B of this practice aid.

5.02 The quality control policies and procedures established by a closely aligned CPA firm that may or may not perform audit services are illustrated in chapters 2–3, as applicable. Additional quality control policies and procedures relevant to alternative practice structures may be necessary when certain portions of the CPA firm's system of quality control (*a*) reside at the non-CPA-owned entity or (*b*) operate in conjunction with the system of quality control of the non-CPA-owned entity.

5.03 Elements of quality control that might reside in a non-CPA-owned entity include the following:

- Relevant ethical requirements
- Human resources
- Monitoring of relevant ethical requirements and human resources

For example, the non-CPA-owned entity may be responsible for hiring personnel for both firms.

5.04 This chapter describes how Non-CPA-Owned Entity and Closely Aligned CPA Firm, hypothetical firms that are organized in an alternative practice structure, implement incremental quality control policies and procedures to address the previously mentioned elements of quality control that reside at Non-CPA-Owned Entity. Closely Aligned CPA Firm has no issuer clients [fn 2] and implements the policies and procedures described in chapter 2, "System of Quality Control for a CPA Firm's Accounting and Auditing Practice—Firm With Multiple Offices," of this practice aid.

[fn 1] A *non-CPA-owned entity* is an entity that is closely aligned to a CPA firm through common employment; leasing of employees, equipment, or facilities; or other similar arrangements. In addition to one or more professional service subsidiaries or divisions that offer nonattest professional services (for example, tax, personal financial planning, and management consulting), a non-CPA-owned entity may have subsidiaries or divisions such as a bank, insurance company, or broker-dealer.

[fn 2] If the closely aligned CPA firm were to be engaged to perform audit services for an issuer, the non-CPA-owned entity or its affiliated companies might need to revise their quality control policies and procedures to comply with PCAOB standards and to reflect SEC requirements applicable to audits of issuers.

Quality Control Policies and Procedures

5.05 *Policy 1: The top-tier company* [fn 3] *maintains a system of quality control.* Non-CPA-Owned Entity implements this policy through the following procedures:

- Designating a qualified individual to be responsible for the following:
  - — Designing and directing the quality control activities at the top-tier company
  - — Disseminating information to all subsidiaries and affiliated entities, all subsidiaries associated with CPA firms, and all CPA firms closely aligned with company subsidiaries
- Providing all company personnel and indirect superiors [fn 4] with access to the company's quality control policies and procedures

Relevant Ethical Requirements

5.06 The purpose of the relevant ethical requirements element of a system of quality control is to provide the firm with reasonable assurance that the firm and its personnel comply with relevant ethical requirements when discharging professional responsibilities. Relevant ethical requirements include independence, integrity, and objectivity. Closely Aligned CPA Firm obtains this assurance by ensuring that Non-CPA-Owned Entity establishes and maintains the policies and procedures described in paragraphs 5.07–.09.

5.07 *Policy 1: Non-CPA-Owned Entity adheres to applicable relevant ethical requirements such as those in regulations, interpretations, and rules of the AICPA, state CPA societies, state boards of accountancy, state statutes,the U.S. Government Accountability Office, and any other applicable regulators.* Non-CPA-Owned Entity implements this policy through the following procedures:

- Developing policies and procedures to ensure the independence of Closely Aligned CPA Firm as required by the applicable aforementioned regulators. (Non-CPA-Owned Entity is required to be independent only in the context of its alignment with the CPA firm; it does not perform any attest functions, so its independence is not relevant.)
- Designating an officer to be responsible for providing guidance, answering questions, monitoring compliance, and resolving matters concerning independence, integrity, and objectivity of Closely Aligned CPA Firm.
- Determining when consultation with outside sources regarding independence, integrity, and objectivity matters is required.
- Reviewing written representations from *direct superiors* and *indirect superiors* [fn 5] and others as applicable and resolving potential independence, integrity, and objectivity matters.

[fn 3] The top-tier company is the parent company of the non-CPA-owned entity, which may be an issuer.

[fn 4] Indirect superiors may be involved in regional management of direct superiors; thus, they may need to adhere to requirements.

- Maintaining documentation of the resolution of independence, integrity, and objectivity matters.

- Requiring entity personnel to obtain sufficient training and education to accomplish their responsibilities with respect to independence, integrity, and objectivity.

- Obtaining from Closely Aligned CPA Firm a current list of all entities with which firm personnel are prohibited from having a financial or business relationship. [fn 6]

- Obtaining written representations from personnel of Non-CPA-Owned Entity, upon hire and on an annual basis, stating that they are familiar with and in compliance with Non-CPA-Owned Entity's policies and procedures regarding independence, integrity, and objectivity.

5.08 *Policy 2: Personnel of Non-CPA-Owned Entity are familiar with policies and procedures regarding relevant ethical requirements.* Non-CPA-Owned Entity implements this policy through the following procedures:

- Providing all of its personnel with access to its policies and procedures and guidance materials related to independence, integrity, and objectivity, such as manuals, memoranda, and databases containing professional and regulatory literature

- Advising personnel of Non-CPA-Owned Entity of the financial or other relationships, circumstances, or activities involving either individuals or entities that may be prohibited, as in the following examples:

  — Business relationships with Closely Aligned CPA Firm's clients or with nonclients that have investor or investee relationships with Closely Aligned CPA Firm's clients

  — Loans to and from Closely Aligned CPA Firm's clients, including loans from Closely Aligned CPA Firm's financial institution clients

  — Family members who are employed by Closely Aligned CPA Firm's clients or who serve as director, officer, manager, or in other audit-sensitive positions with clients of Closely Aligned CPA Firm, including not-for-profit organizations

  — Past due fees from Closely Aligned CPA Firm's clients

[fn 5] *Direct superiors* are defined to include those persons so closely associated with a partner or manager who is a covered member that such persons can directly control the activities of such partner or manager. For this purpose, a person who can directly control is the immediate superior of the partner or manager who has the power to direct the activities of that person to be able to directly or indirectly (for example, through another entity over which the direct superior can exercise significant influence) derive a benefit from that person's activities. Examples would be the person who has day-to-day responsibility for the activities of the partner or manager and is in a position to recommend promotions and compensation levels. *Indirect superiors* are those persons who are one or more levels above direct superiors. Generally, this would start with persons in an organization structure to whom direct superiors report and go up the line from there.

[fn 6] Examples of business relationships prohibited by independence standard-setting bodies such as the AICPA, the U.S. Government Accountability Office, and the U.S. Department of Labor because they might impair independence include being an investor in a joint venture with a client that is material or serving as a board member on the board of an audit client.

— Services in which the service provider assumes some of the responsibilities of client management

— Performing certain bookkeeping services for governmental entities that are clients of Closely Aligned CPA Firm

— Client relationships with Non-CPA-Owned Entity in which Closely Aligned CPA Firm leases employees, facilities, and so on

— Situations in which personnel of Non-CPA-Owned Entity act as promoters, underwriters, voting trustees, directors, or officers of Closely Aligned CPA Firm's clients

— Direct and material indirect financial interests in clients of Closely Aligned CPA Firm

— Material investments by Closely Aligned CPA Firm's clients in Non-CPA-Owned Entity that allow the clients to exercise significant influence over Non-CPA-Owned Entity

- Advising personnel of Non-CPA-Owned Entity of the following:

  — All direct superiors with whom, and all activities in which, Non-CPA-Owned Entity is prohibited from engaging, as defined in Non-CPA-Owned Entity's independence policies and procedures

  — All indirect superiors with whom, and all activities in which, Non-CPA-Owned Entity is prohibited from engaging, as defined by Non-CPA-Owned Entity's policies and procedures

- Obtaining client lists from Closely Aligned CPA Firm to inform all personnel, on a timely basis, of Closely Aligned CPA Firm client's to which independence policies apply

- Obtaining documented representations from all Non-CPA-Owned Entity personnel (including those defined as direct and indirect superiors or supervisors of affiliated issuers), [fn 7] upon hire and on an annual basis thereafter, stating that they are familiar with and in compliance with policies and procedures regarding relevant ethical requirements

5.09 *Policy 3: Non-CPA-Owned Entity identifies and evaluates possible threats to independence and objectivity and takes appropriate action to eliminate those threats or reduce them to an appropriate level by applying safeguards.* Non-CPA-Owned Entity implements this policy through the following procedures:

- Assigning responsibility for obtaining, maintaining, and reviewing documented representations from all Non-CPA-Owned Entity personnel (see paragraph 5.08) for completeness and resolving reported exceptions with Non-CPA-Owned Entity's chief executive

[fn 7] Affiliated issuers include the top-tier company and all entities consolidated in the top-tier company's financial statements. Individuals in these entities are not in situations in which a direct superior can exercise significant influence.

- Requiring the chief executive of Non-CPA-Owned Entity to review or to designate an appropriate individual to review unpaid fees from clients of Closely Aligned CPA Firm to ascertain whether any outstanding amounts impair Closely Aligned CPA Firm's independence

- Requiring all professionals to report, on a timely basis when identified, circumstances and relationships that form a threat to independence so that appropriate action can be taken

- Requiring all professionals to report, on a timely basis when identified, apparent violations of independence, integrity, or objectivity policies involving themselves, their spouses, or their dependents and the corrective actions taken or proposed to be taken

Human Resources

5.10 The purpose of the human resources element of a system of quality control is to provide the firm with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary (*a*) to perform its engagements in accordance with professional standards and regulatory and legal requirements and (*b*) to enable the firm to issue reports that are appropriate in the circumstances. Closely Aligned CPA Firm obtains this assurance by ensuring that Non-CPA-Owned Entity establishes and maintains the policies and procedures comparable to those that are described in paragraphs 5.11–.13 with regard to its leased or per diem personnel.

5.11 *Policy 1: Leased or per diem personnel possess characteristics that enable them to competently perform and review engagements.* Non-CPA-Owned Entity implements this policy by having knowledge and experience equivalent to that of Closely Aligned CPA Firm to make the following decisions:

- Designating an individual from Closely Aligned CPA Firm to be responsible for hiring and managing human resources within Non-CPA-Owned Entity on behalf of Closely Aligned CPA Firm.

- Reviewing Closely Aligned CPA Firm's personnel requirements for attest engagements to ensure that sufficient and capable staff persons are available to perform those engagements.

- Involving members of Closely Aligned CPA Firm in the process of hiring professionals on behalf of Closely Aligned CPA Firm that include establishing the attributes, achievements, and experiences desired in entry-level and experienced personnel. Such criteria assist in evaluating (*a*) the personal characteristics of professionals, such as integrity, competence, and motivation, and (*b*) whether professionals can competently perform responsibilities within Closely Aligned CPA Firm.

- Establishing guidelines for additional procedures to be performed when hiring experienced personnel, such as performing background checks and inquiring about any outstanding regulatory actions.

- Establishing criteria for determining which individuals will be involved in interviewing and hiring personnel on behalf of Closely Aligned CPA Firm.

5.12 *Policy 2: Leased or per diem personnel participate in general and industry-specific continuing professional education (CPE) and other professional activities that enable them to accomplish assigned responsibilities and satisfy applicable CPE requirements of the AICPA, state CPA societies, state accountancy boards, and other regulatory agencies.* Non-CPA-Owned Entity implements this policy through the following procedures:

- Designating an individual to be responsible for CPE and professional development activities, including maintaining appropriate documentation evidencing that leased and per diem personnel have met the professional education requirements of the AICPA, state boards of accountancy, and other applicable regulators

- Establishing policies that require individuals performing audits, reviews, compilations, or attestation engagements for Closely Aligned CPA Firm to participate in CPE related to accounting and auditing

- Establishing policies requiring all leased or per diem personnel to be in compliance with the professional education requirements of the boards of accountancy in states where they are licensed and with the AICPA, state societies, and other regulatory agencies, as applicable

- Establishing an orientation and training policy for new hires who will perform audits, reviews, compilations, or attestation engagements for Closely Aligned CPA Firm or who will have partner- or manager-level responsibility for the overall supervision or review of such engagements

- Ensuring that leased or per diem personnel are informed about changes in accounting and auditing standards, independence, integrity, and objectivity requirements, and Closely Aligned CPA Firm's technical policies and procedures that are relevant to them

- Encouraging leased or per diem personnel to participate in other professional activities, such as graduate-level courses, membership in professional organizations, and serving on professional committees

5.13 *Policy 3**:** Leased or per diem personnel who are selected for advancement have the qualifications to accomplish the responsibilities they will be called upon to assume. Factors to consider include the degree of technical training and proficiency required in the circumstances and the nature and extent of supervision of assignments relating to audits, reviews, compilations, or attestation engagements performed by Closely Aligned CPA Firm.* Non-CPA-Owned Entity implements this policy through the following procedures:

- Establishing a system for providing information to Closely Aligned CPA Firm so that it can make appropriate personnel decisions, such as assignments for audits, reviews, compilations, and attestation engagements.

- Designating an individual to be responsible for the following:

  — Establishing criteria for the evaluation and advancement of leased or per diem personnel, including appropriate documentation.

  — Making advancement and termination decisions, including identifying responsibilities and requirements for evaluation, at each professional level and deciding who will prepare those evaluations.

  — Developing appropriate evaluation forms.

  — Reviewing performance evaluations with personnel, discussing future objectives of Closely Aligned CPA Firm and the individual, and discussing assignment preferences.

— Periodically evaluating owners of Closely Aligned CPA Firm by means of peer evaluation or self-appraisal.

— Counseling leased or per diem personnel regarding their progress and career opportunities.

- Establishing an arrangement with Closely Aligned CPA Firm in which a supervisory-level individual of Closely Aligned CPA Firm is responsible for assisting Non-CPA-Owned Entity in making advancement and termination decisions concerning leased or per diem personnel. This would include evaluating personnel needs, establishing hiring objectives, and providing final approval.

- Developing a system for evaluating the performance of leased or per diem personnel and advising them of their progress.

Monitoring

5.14 The purpose of the monitoring element of a system of quality control is to provide the firm and its engagement partners with reasonable assurance that the policies and procedures related to the system of quality control are relevant, adequate, operating effectively, and complied with in practice. Monitoring involves an ongoing consideration and evaluation of the appropriateness of the design, the effectiveness of the operation of a firm's quality control system, and a firm's compliance with its quality control policies and procedures. The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of the following:

- Adherence to professional standards and regulatory and legal requirements

- Whether the quality control system has been appropriately designed and effectively implemented

- Whether the firm's quality control policies and procedures have been operating effectively so that reports that are issued by the CPA firm are appropriate in the circumstances

5.15 A CPA firm that is closely aligned with a non-CPA-owned entity obtains this assurance by ensuring that the non-CPA-owned entity establishes and maintains the policies and procedures described in paragraphs 5.16–.19.

5.16 *Policy 1: Non-CPA-Owned Entity considers and evaluates, on an ongoing basis, the relevance and adequacy of its policies and procedures related to relevant ethical requirements that are applicable to all its personnel and its personnel management policies and procedures that are applicable to leased or per diem personnel.* Non-CPA-Owned Entity implements this policy by designating qualified individuals to be responsible for monitoring quality assurance, including ensuring that Non-CPA-Owned Entity's quality control guidance is regularly updated to reflect changes in professional standards related to independence, CPE, and other regulatory requirements through the following procedures:

- Implementing a system of ongoing monitoring of the effectiveness and appropriateness of policies and procedures related to independence, objectivity, and integrity as applicable to all personnel of Non-CPA-Owned Entity and compliance with those policies and procedures

- Ensuring, on an ongoing basis, that guidance materials and any practice aids Non-CPA-Owned Entity provides to Closely Aligned CPA Firm are appropriately designed to assist Closely Aligned CPA Firm in adhering to quality control standards

- Maintaining a system to ensure that the practice aids regarding independence and other technical matters provided by Non-CPA-Owned Entity are updated to reflect current professional standards and regulatory requirements and are relevant to and effective for Closely Aligned CPA Firm's practice

- Ensuring that Non-CPA-Owned Entity informs and provides guidance to leased or per diem personnel regarding new professional standards, regulatory requirements, and related changes to relevant Closely Aligned CPA Firm policies or practice aids

5.17 *Policy 2: Non-CPA-Owned Entity considers and evaluates, on an ongoing basis, compliance with its policies and procedures related to relevant ethical requirements that are applicable to all of its personnel and personnel management policies and procedures that are applicable to leased or per diem personnel.* Non-CPA-Owned Entity implements this policy by considering and evaluating, on an ongoing basis, compliance with policies and procedures related to independence, integrity, and objectivity, as applicable to all of its personnel, through the following procedures:

- Performing timely monitoring of policies and procedures, on an ongoing basis, related to independence, integrity, and objectivity to evaluate compliance with those policies and procedures. The monitoring policies and procedures could include an internal audit function, ongoing review by senior management, or engaging an independent CPA to examine and report on compliance.

- Summarizing and communicating the results of the monitoring to all of its personnel and communicating any suggested changes to policies and procedures to the appropriate levels of personnel in Non-CPA-Owned Entity.

- Correcting noted deficiencies based on the results of the monitoring to ensure compliance with policies and procedures.

5.18 *Policy 3: Non-CPA-Owned Entity deals appropriately with complaints and allegations.* Non-CPA-Owned Entity implements this policy through the following procedures:

- Establishing procedures for concerns to be brought to the attention of the ethics committee in a confidential manner.

- Having the firm's ethics committee (excluding any members who are otherwise involved in the engagement under investigation) investigate the following:

  — Complaints and allegations that the work performed by the firm fails to comply with professional standards and regulatory and legal requirements.

  — Allegations of noncompliance with the firm's system of quality control.

  — Deficiencies in the design or operation of the firm's quality control policies and procedures, or noncompliance with the firm's system of quality control by an individual or individuals, as identified during the investigations into complaints and allegations.

- Documenting complaints and allegations and the responses to them.

5.19 *Policy 4: Non-CPA-Owned Entity prepares appropriate documentation to provide evidence of the operation of each element of its system of quality control.* Non-CPA-Owned Entity implements this policy by preparing and retaining documentation that provides evidence of the operation of the system of quality control for a period of time sufficient to permit those performing monitoring procedures to evaluate the firm's compliance with its system of quality control.

Appendix A

QC Section 10, A Firm's System of Quality Control

(Supersedes SQCS No. 7.)

Source: SQCS No. 8; SAS No. 122; SAS No. 128.

Effective date: Applicable to a CPA firm's system of quality control for its accounting and auditing practice as of January 1, 2012.

Introduction

Scope of This Section

.01 This section addresses a CPA firm's responsibilities for its system of quality control for its accounting and auditing practice. This section is to be read in conjunction with the AICPA Code of Professional Conduct and other relevant ethical requirements.

.02 This section, although applicable to audit and attestation engagements performed by CPA firms in accordance with *Government Auditing Standards,* does not apply to government audit organizations. Instead, those government audit organizations are subject to the quality control and assurance requirements of *Government Auditing Standards,* which are similar to those of this section.

.03 Other professional standards set out additional requirements and guidance on the responsibilities of firm personnel regarding quality control procedures for specific types of engagements. AU-C section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards,* for example, addresses quality control procedures for engagements conducted in accordance with generally accepted auditing standards. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

.04 A system of quality control consists of policies designed to achieve the objective set out in paragraph .12 and the procedures necessary to implement and monitor compliance with those policies.

Authority of the SQCSs

.05 This section applies to all CPA firms with respect to engagements in their accounting and auditing practice. The nature and extent of the policies and procedures developed by an individual firm to comply with this section will depend on various factors, such as the size and operating characteristics of the firm and whether it is part of a network.

.06 Statements on Quality Control Standards (SQCSs) contain the objective of the firm in following the SQCSs and requirements designed to enable the firm to meet that stated objective. In addition, SQCSs contain related guidance in the form of application and other explanatory material, as discussed further in paragraph .09, and introductory material that provides context relevant to a proper understanding of the SQCSs and definitions.

.07 The objective provides the context in which the requirements of SQCSs are set and is intended to assist the firm in the following:

- Understanding what needs to be accomplished

- Deciding whether more needs to be done to achieve the objective

.08 SQCSs use two categories of professional requirements, identified by specific terms, to describe the degree of responsibility they impose on firms, as follows:

- *Unconditional requirements*. The firm is required to comply with an unconditional requirement in all cases in which such a requirement is relevant. SQCSs use the word *must* to indicate an unconditional requirement.

- *Presumptively mandatory requirements*. The firm is also required to comply with a presumptively mandatory requirement in all cases in which such a requirement is relevant; however, in rare circumstances, the firm may depart from a presumptively mandatory requirement, provided that the firm documents the justification for the departure and how the alternative policies established, or procedures performed, in the circumstances were sufficient to achieve the objectives of the presumptively mandatory requirement. SQCSs use the word *should* to indicate a presumptively mandatory requirement.

If an SQCS provides that a procedure or action is one that the firm "should consider," the consideration of the procedure or action is presumptively required, whereas carrying out the procedure or action is not. The professional requirements of an SQCS are to be understood and applied in the context of the explanatory material that provides guidance for their application.

.09 When necessary, the application and other explanatory material provides further explanation of the requirements and guidance for carrying them out. In particular, it may

- explain more precisely what a requirement means or is intended to cover.

- include examples of policies and procedures that may be appropriate in the circumstances.

The words *may*, *might*, and *could*, among others, are used to describe these actions and procedures. Although such guidance does not, in itself, impose a requirement, it is relevant to the proper application of the requirements. The application and other explanatory material may also provide background information on matters addressed in SQCSs. When appropriate, additional considerations specific to governmental entities or smaller firms are included within the application and other explanatory material. These additional considerations assist in the application of the requirements in SQCSs. They do not, however, limit or reduce the responsibility of the firm to apply and comply with the requirements in SQCSs.

.10 SQCSs include, under the heading "Definitions," a description of the meanings attributed to certain terms for purposes of the SQCSs. These are provided to assist in the consistent application and interpretation of SQCSs and are not intended to override definitions that may be established for other purposes, whether in law, regulation, or otherwise. The AU-C glossary contains a complete listing of terms defined in this section. It also includes descriptions of other terms found in this section to assist in common and consistent interpretation. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Effective Date

.11 The provisions of this section are applicable to a CPA firm's system of quality control for its accounting and auditing practice as of January 1, 2012.

Objective

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

a. the firm and its personnel comply with professional standards and applicable legal and regulatory requirements and

b. reports issued by the firm are appropriate in the circumstances.

Definitions

.13 For purposes of SQCSs, the following terms have the meanings attributed as follows:

Accounting and auditing practice. A practice that performs engagements covered by this section, which are audit, attestation, compilation, review, and any other services for which standards have been promulgated by the AICPA Auditing Standards Board (ASB) or the AICPA Accounting and Review Services Committee (ARSC) under the "General Standards Rule" (ET sec. 1.300.001) or the "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct. Although standards for other engagements may be promulgated by other AICPA technical committees, engagements performed in accordance with those standards are not encompassed in the definition of an *accounting and auditing practice*.

Engagement documentation. The record of the work performed, results obtained, and conclusions that the practitioner reached (also known as *working papers* or *workpapers*).

Engagement partner. The partner or other person in the firm who is responsible for the engagement and its performance and for the report that is issued on behalf of the firm and who, when required, has the appropriate authority from a professional, legal, or regulatory body.

Engagement quality control review. A process designed to provide an objective evaluation, before the report is released, of the significant judgments the engagement team made and the conclusions it reached in formulating the report. The engagement quality control review process is only for those engagements, if any, for which the firm has determined that an engagement quality control review is required, in accordance with its policies and procedures.

Engagement quality control reviewer. A partner, other person in the firm, suitably qualified external person, or team made up of such individuals, none of whom is part of the engagement team, with sufficient and appropriate experience and authority to objectively evaluate the significant judgments that the engagement team made and the conclusions it reached in formulating the report.

Engagement team. All partners and staff performing the engagement and any individuals engaged by the firm or a network firm who perform procedures on the engagement. This excludes external specialists engaged by the firm or a network firm. [fn 1]

The term *engagement team* also excludes individuals within the client's internal audit function who provide direct assistance on an audit engagement when the external auditor complies with the requirements of section 610, *Using the Work of Internal Auditors*.

Firm. A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the AICPA and that is engaged in public practice.

Inspection. A retrospective evaluation of the adequacy of the firm's quality control policies and procedures, its personnel's understanding of those policies and procedures, and the extent of the firm's compliance with them. Inspection includes a review of completed engagements.

Monitoring. A process comprising an ongoing consideration and evaluation of the firm's system of quality control, including inspection or a periodic review of engagement documentation, reports, and clients' financial statements for a selection of completed engagements, designed to provide the firm with reasonable assurance that its system of quality control is designed appropriately and operating effectively.

Network. An association of entities, as defined in ET section 0.400, *Definitions*.

Network firm. A firm or other entity that belongs to a network, as defined in ET section 0.400.

Partner. Any individual with authority to bind the firm with respect to the performance of a professional services engagement. For purposes of this definition, *partner* may include an employee with this authority who has not assumed the risks and benefits of ownership. Firms may use different titles to refer to individuals with this authority.

Personnel. Partners and staff.

Professional standards. Standards promulgated by the ASB or ARSC under the "General Standards Rule" or the "Compliance With Standards Rule" of the AICPA Code of Professional Conduct, or other standards-setting bodies that set auditing and attest standards applicable to the engagement being performed and relevant ethical requirements.

Reasonable assurance. In the context of this section, a high, but not absolute, level of assurance.

Relevant ethical requirements. Ethical requirements to which the firm and its personnel are subject, which consist of the AICPA Code of Professional Conduct together with rules of applicable state boards of accountancy and applicable regulatory agencies that are more restrictive.

Staff. Professionals, other than partners, including any specialists that the firm employs.

[fn 1] Paragraph .06 of AU-C section 620, *Using the Work of an Auditor's Specialist*, defines the term *auditor's specialist*. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Suitably qualified external person. An individual outside the firm with the competence and capabilities to act as an engagement partner (for example, a partner of another firm).

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

Requirements

Applying and Complying With Relevant Requirements

.14 Personnel within the firm responsible for establishing and maintaining the firm's system of quality control should have an understanding of the entire text of this section, including its application and other explanatory material, to understand its objective and apply its requirements properly.

.15 The firm should comply with each requirement of this section unless, in the circumstances of the firm, the requirement is not relevant to the services provided by a firm's accounting and auditing practice. (Ref: par. .A1)

.16 The requirements are designed to enable the firm to achieve the objective stated in this section. The proper application of the requirements is, therefore, expected to provide a sufficient basis for the achievement of the objective. However, because circumstances vary widely and all such circumstances cannot be anticipated, the firm should consider whether there are particular matters or circumstances that require the firm to establish policies and procedures in addition to those required by this section to meet the stated objective.

Elements of a System of Quality Control

.17 The firm must establish and maintain a system of quality control. The system of quality control should include policies and procedures addressing each of the following elements:

a. Leadership responsibilities for quality within the firm (the tone at the top)

b. Relevant ethical requirements

c. Acceptance and continuance of client relationships and specific engagements

d. Human resources

e. Engagement performance

f. Monitoring

Policies and procedures established by the firm related to each element are designed to achieve reasonable assurance with respect to the purpose of that element. Deficiencies in policies and procedures for an element may result in not achieving reasonable assurance with respect to the purpose of that element; however, the system of quality control as a whole may still be effective in achieving the objective described in paragraph .12.

.18 The firm should document its policies and procedures and communicate them to the firm's personnel. (Ref: par. .A2–.A3)

Leadership Responsibilities for Quality Within the Firm

.19 The firm should establish policies and procedures designed to promote an internal culture based on the recognition that quality is essential in performing engagements. Such policies and procedures should require the firm's leadership (managing partner or board of managing partners, CEO, or equivalent) to assume ultimate responsibility for the firm's system of quality control. (Ref: par. .A4–.A5)

.20 The firm should establish policies and procedures designed to provide it with reasonable assurance that any person or persons assigned operational responsibility for the firm's system of quality control by the firm's leadership has sufficient and appropriate experience and ability, and the necessary authority, to assume that responsibility. (Ref: par. .A6)

Relevant Ethical Requirements

.21 The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements. (Ref: par. .A7–.A9)

Independence

.22 The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm; its personnel; and, when applicable, others subject to independence requirements (including network firm personnel) maintain independence when required by relevant ethical requirements. Such policies and procedures should enable the firm to

a. communicate its independence requirements to its personnel and, when applicable, others subject to them and

b. identify and evaluate circumstances and relationships that create threats to independence and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards or, if considered appropriate, to withdraw from the engagement when withdrawal is possible under applicable law or regulation.

.23 Such policies and procedures should require

a. engagement partners to provide the firm with relevant information about client engagements, including the scope of services, to enable the firm to evaluate the overall effect, if any, on independence requirements;

b. personnel to promptly notify the firm of circumstances and relationships that create a threat to independence so that appropriate action can be taken; and

c. the accumulation and communication of relevant information to appropriate personnel so that

i. the firm and its personnel can readily determine whether they satisfy independence requirements,

ii. the firm can maintain and update information relating to independence, and

iii. the firm can take appropriate action regarding identified threats to independence that are not at an acceptable level.

.24 The firm should establish policies and procedures designed to provide it with reasonable assurance that it is notified of breaches of independence requirements and to enable it to take appropriate actions to resolve such situations. The policies and procedures should include requirements for

a. personnel to promptly notify the firm of independence breaches of which they become aware;

b. the firm to promptly communicate identified breaches of these policies and procedures to

i. the engagement partner who, with the firm, needs to address the breach and

ii. other relevant personnel in the firm and, when appropriate, the network and those subject to the independence requirements who need to take appropriate action; and

c. prompt communication to the firm, if necessary, by the engagement partner and the other individuals referred to in subparagraph (b)(ii) of the actions taken to resolve the matter so that the firm can determine whether it should take further action.

.25 At least annually, the firm should obtain written confirmation of compliance with its policies and procedures on independence from all firm personnel required to be independent by the requirements set forth in the "Independence Rule" (ET sec. 1.200.001) and related interpretations of the AICPA Code of Professional Conduct and the rules of state boards of accountancy and applicable regulatory agencies. (Ref: par. .A10) [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

.26 The firm should establish policies and procedures for all audit or attestation engagements for which regulatory or other authorities require the rotation of personnel after a specified period, in compliance with such requirements.

Acceptance and Continuance of Client Relationships and Specific Engagements

.27 The firm should establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide the firm with reasonable assurance that it will undertake or continue relationships and engagements only when the firm

a. is competent to perform the engagement and has the capabilities, including time and resources, to do so; (Ref: par. .A11)

b. can comply with legal and relevant ethical requirements; and

c. has considered the integrity of the client and does not have information that would lead it to conclude that the client lacks integrity. (Ref: par. .A12–.A13)

.28 Such policies and procedures should

a. require the firm to obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. (Ref: par. .A14)

b. require the firm to determine whether it is appropriate to accept the engagement if a potential conflict of interest is identified in accepting an engagement from a new or an existing client.

c. if issues have been identified and the firm decides to accept or continue the client relationship or a specific engagement, require the firm to

i. consider whether ethical requirements that exist under the "Conflicts of Interest" interpretation (ET sec. 1.110.010) under the “Integrity and Objectivity Rule” (ET sec. 1.100.001) apply, and

ii. document how the issues were resolved.

[Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

.29 To minimize the risk of misunderstandings regarding the nature, scope, and limitations of the services to be performed, the firm should establish policies and procedures that provide for obtaining an understanding with the client regarding those services. (Ref: par. .A15)

.30 The firm should establish policies and procedures on continuing an engagement and the client relationship that address the circumstances when the firm obtains information that would have caused it to decline the engagement had that information been available earlier. Such policies and procedures should include consideration of the following:

a. The professional and legal responsibilities that apply to the circumstances, including whether there is a requirement for the firm to report to regulatory authorities

b. The possibility of withdrawing from the engagement or from both the engagement and the client relationship (Ref: par. .A16)

Human Resources

.31 The firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the competence, capabilities, and commitment to ethical principles necessary to

a. perform engagements in accordance with professional standards and applicable legal and regulatory requirements and

b. enable the firm to issue reports that are appropriate in the circumstances. (Ref: par. .A17–.A24)

.32 The firm’s policies and procedures should provide that personnel selected for advancement have the qualifications necessary for fulfillment of the responsibilities that they will be called on to assume.

Assignment of Engagement Teams

.33 The firm should assign responsibility for each engagement to an engagement partner and should establish policies and procedures requiring that

a. the identity and role of the engagement partner are communicated to management and those charged with governance;

b. the engagement partner has the appropriate competence, capabilities, and authority to perform the role; and (Ref: par. .A25–.A30)

c. the responsibilities of the engagement partner are clearly defined and communicated to that individual.

.34 The firm should establish policies and procedures to assign appropriate personnel with the necessary competence and capabilities to

a. perform engagements in accordance with professional standards and applicable legal and regulatory requirements and

b. enable the firm to issue reports that are appropriate in the circumstances. (Ref: par. .A31)

Engagement Performance

.35 The firm should establish policies and procedures designed to provide it with reasonable assurance that engagements are performed in accordance with professional standards and applicable legal and regulatory requirements and that the firm issues reports that are appropriate in the circumstances. Such policies and procedures should include the following:

a. Matters relevant to promoting consistency in the quality of engagement performance (Ref: par. .A32–.A33)

b. Supervision responsibilities (Ref: par. .A34)

c. Review responsibilities (Ref: par. .A35)

.36 The firm's review responsibility policies and procedures should be determined on the basis that suitably experienced engagement team members, which may include the engagement partner, review work performed by other engagement team members.

Consultation

.37 The firm should establish policies and procedures designed to provide it with reasonable assurance that

a. appropriate consultation takes place on difficult or contentious issues;

b. sufficient resources are available to enable appropriate consultation to take place;

c. the nature and scope of such consultations are documented and are agreed upon by both the individual seeking consultation and the individual consulted; and

d. the conclusions resulting from consultations are documented, understood by both the individual seeking consultation and the individual consulted, and implemented. (Ref: par. .A36–.A40)

Engagement Quality Control Review

.38 The firm should establish criteria against which all engagements covered by this section should be evaluated to determine whether an engagement quality control review should be performed. (Ref: par. .A41)

.39 The firm's policies and procedures should require that if an engagement meets the criteria established, an engagement quality control review should be performed for that engagement.

.40 The firm should establish policies and procedures setting out the nature, timing, and extent of an engagement quality control review. Such policies and procedures should require that the engagement quality control review be completed before the report is released. (Ref: par. .A42–.A44)

.41 The firm should establish policies and procedures to require the engagement quality control review to include

a. discussion of significant findings and issues with the engagement partner;

b. reading the financial statements or other subject matter information and the proposed report;

c. review of selected engagement documentation relating to significant judgments that the engagement team made and the related conclusions it reached; and

d. evaluation of the conclusions reached in formulating the report and consideration of whether the proposed report is appropriate. (Ref: par. .A45–.A47)

Criteria for the Eligibility of Engagement Quality Control Reviewers

.42 The firm should establish policies and procedures to address the appointment of engagement quality control reviewers and to establish their eligibility through

a. the technical qualifications required to perform the role, including the necessary experience and authority, and (Ref: par. .A48)

b. the degree to which an engagement quality control reviewer can be consulted on the engagement without compromising the reviewer's objectivity. (Ref: par. .A49)

.43 The firm should establish policies and procedures designed to maintain the objectivity of the engagement quality control reviewer. Such policies and procedures should provide that although the engagement quality control reviewer is not a member of the engagement team, the engagement quality control reviewer should satisfy the independence requirements relating to the engagements reviewed. Accordingly, such policies and procedures should provide that the engagement quality control reviewer

a. when practicable, is not selected by the engagement partner.

b. does not otherwise participate in the performance of the engagement during the period of review.

c. does not make decisions for the engagement team.

d. is not subject to other considerations that would threaten the reviewer's objectivity.

.44 The firm's policies and procedures should provide for the replacement of the engagement quality control reviewer when the reviewer's ability to perform an objective review is likely to have been impaired. (Ref: par. .A50)

Documentation of the Engagement Quality Control Review

.45 The firm should establish policies and procedures on documentation of the engagement quality control review, which require documentation that

a. the procedures required by the firm's policies on engagement quality control review have been performed;

b. the engagement quality control review has been completed before the report is released; and

c. the reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments that the engagement team made and the conclusions it reached were not appropriate.

Differences of Opinion

.46 The firm should establish policies and procedures for addressing and resolving differences of opinion within the engagement team; with those consulted; and, when applicable, between the engagement partner and the engagement quality control reviewer. (Ref: par. .A51–.A52)

.47 Such policies and procedures should enable a member of the engagement team to document that member's disagreement with the conclusions reached after appropriate consultation.

.48 Such policies and procedures should require the following:

a. Conclusions reached be documented and implemented

b. The report not be released until the matter is resolved

Engagement Documentation

Completion of the Assembly of Final Engagement Files

.49 The firm should establish policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis after the engagement reports have been released. (Ref: par. .A53–.A54)

Confidentiality, Safe Custody, Integrity, Accessibility, and Retrievability of Engagement Documentation

.50 The firm should establish policies and procedures designed to maintain the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation. (Ref: par. .A55–.A58)

Retention of Engagement Documentation

.51 The firm should establish policies and procedures for the retention of engagement documentation for a period sufficient to meet the needs of the firm, professional standards, laws, and regulations. (Ref: par. .A59–.A62)

Monitoring

Monitoring the Firm's Quality Control Policies and Procedures

.52 The firm should establish a monitoring process designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively. This process should

a. include an ongoing consideration and evaluation of the firm's system of quality control, including inspection or a periodic review of engagement documentation, reports, and clients' financial statements for a selection of completed engagements;

b. require responsibility for the monitoring process to be assigned to a partner or partners or other persons with sufficient and appropriate experience and authority in the firm to assume that responsibility; and

c. assign the performance of monitoring the firm's system of quality control to qualified individuals. (Ref: par. .A63–.A73)

Evaluating, Communicating, and Remedying Identified Deficiencies

.53 Any system of quality control has inherent limitations that can reduce its effectiveness. Deficiencies in individual engagements covered by this section do not, in and of themselves, indicate that the firm's system of quality control is insufficient to provide it with reasonable assurance that its personnel comply with applicable professional standards.

.54 The firm should evaluate the effect of deficiencies noted as a result of the monitoring process and determine whether they are either

a. instances that do not necessarily indicate that the firm's system of quality control is insufficient to provide it with reasonable assurance that it complies with professional standards and applicable legal and regulatory requirements and that the reports issued by the firm are appropriate in the circumstances or

b. systemic, repetitive, or other significant deficiencies that require prompt corrective action.

.55 The firm should communicate to relevant engagement partners, and other appropriate personnel, deficiencies noted as a result of the monitoring process and recommendations for appropriate remedial action. (Ref: par. .A74)

.56 Recommendations for appropriate remedial actions for deficiencies noted should include one or more of the following:

a. Taking appropriate remedial action in relation to an individual engagement or member of personnel

b. The communication of the findings to those responsible for training and professional development

c. Changes to the quality control policies and procedures

d. Disciplinary action against those who fail to comply with the policies and procedures of the firm, especially those who do so repeatedly

.57 The firm should establish policies and procedures to address cases when the results of the monitoring procedures indicate that a report may be inappropriate or that procedures were omitted during the performance of the engagement. Such policies and procedures should require the firm to

a. determine what further action is appropriate to comply with relevant professional standards and legal and regulatory requirements and

b. consider whether to obtain legal advice.

.58 The firm should communicate, at least annually, the results of the monitoring of its system of quality control to engagement partners and other appropriate individuals within the firm, including the firm's leadership. This communication should be sufficient to enable the firm and these individuals to take prompt and appropriate action, when necessary, in accordance with their defined roles and responsibilities to provide a basis for them to rely on the firm's system of quality control. Information communicated should include the following:

a. A description of the monitoring procedures performed

b. The conclusions drawn from the monitoring procedures

c. When relevant, a description of systemic, repetitive, or other significant deficiencies and of the actions taken to resolve or amend those deficiencies

.59 Some firms operate as part of a network and, for consistency, may implement some of their monitoring procedures on a network basis. When firms within a network operate under common monitoring policies and procedures designed to comply with this section, and these firms place reliance on such a monitoring system, the firm's policies and procedures should require that

a. at least annually, the network communicate the overall scope, extent, and results of the monitoring process to appropriate individuals within the network firms and

b. the network communicate promptly any identified deficiencies in the quality control system to appropriate individuals within the relevant network firm or firms so that the necessary action can be taken in order that engagement partners in the network firms can rely on the results of the monitoring process implemented within the network, unless the firms or the network advise otherwise.

Complaints and Allegations

.60 The firm should establish policies and procedures designed to provide it with reasonable assurance that it deals appropriately with

a. complaints and allegations that the work performed by the firm fails to comply with professional standards and applicable legal and regulatory requirements and

b. allegations of noncompliance with the firm's system of quality control.

As part of this process, the firm should establish clearly defined channels for firm personnel to raise any concerns in a manner that enables them to come forward without fear of reprisals. (Ref: par. .A75)

.61 If, during the investigations into complaints and allegations, deficiencies in the design or operation of the firm's quality control policies and procedures, or instances of noncompliance with the firm's system of quality control by an individual or individuals are identified, the firm should take appropriate actions, as set out in paragraph .56. (Ref: par. .A76–.A77)

Documentation of the System of Quality Control

.62 The firm should establish policies and procedures requiring appropriate documentation to provide evidence of the operation of each element of its system of quality control. (Ref: par. .A78–.A80)

.63 The firm should establish policies and procedures that require retention of documentation for a period of time sufficient to permit those performing monitoring procedures and peer review of the firm to evaluate the firm's compliance with its system of quality control or for a longer period if required by law or regulation. [fn 2]

.64 The firm should establish policies and procedures requiring documentation of complaints and allegations described in paragraph .60 and the responses to them.

Application and Other Explanatory Material

Applying and Complying With Relevant Requirements

Considerations Specific to Smaller Firms (Ref: par. .15)

.A1 This section does not call for compliance with requirements that are not relevant (for example, in the circumstances of a sole practitioner with no staff). Requirements in this section, such as those for policies and procedures for the assignment of appropriate personnel to the engagement team (see paragraph .34), for review responsibilities (see paragraph .36), and for the annual communication of the results of monitoring to engagement partners within the firm (see paragraph .58) are not relevant in the absence of staff.

Elements of a System of Quality Control (Ref: par. .18)

.A2 In general, communication of quality control policies and procedures to firm personnel includes a description of the quality control policies and procedures and the objectives they are designed to achieve and the message that each individual has a personal responsibility for quality and is expected to comply with these policies and procedures. By encouraging firm personnel to communicate their views or concerns on quality control matters, the firm recognizes the importance of obtaining feedback on the firm's system of quality control. Although communication is enhanced if it is in writing, the communication of quality control policies and procedures is not required to be in writing.

[fn 2] PR section 100, *Standards for Performing and Reporting on Peer Reviews*, is applicable to firms enrolled in the AICPA Peer Review Program.

Considerations Specific to Smaller Firms

.A3 Documentation and communication of policies and procedures for smaller firms may be less formal and extensive than for larger firms.

Leadership Responsibilities for Quality Within the Firm

Promoting an Internal Culture of Quality (Ref: par. .19)

.A4 The firm's leadership, and the examples it sets, significantly influences the internal culture of the firm. The promotion of a quality-oriented internal culture depends on clear, consistent, and frequent actions and messages from all levels of the firm's management that emphasize the firm's quality control policies and procedures and the requirement to

a. perform work that complies with professional standards and applicable legal and regulatory requirements.

b. issue reports that are appropriate in the circumstances.

Such actions and messages encourage a culture that recognizes and rewards quality work. These actions and messages may be communicated by, but are not limited to, training seminars, meetings, formal or informal dialogue, mission statements, newsletters, or briefing memoranda. They may be incorporated in partner and staff appraisal procedures and the firm's internal documentation and training materials, such that they will support and reinforce the firm's view on the importance of quality and how, practically, it is to be achieved.

.A5 Of particular importance in promoting an internal culture based on quality is the need for the firm's leadership to recognize that the firm's business strategy is subject to the overarching requirement for the firm to achieve the objectives of the system of quality control in all the engagements that the firm performs. Promoting such an internal culture includes the following:

a. Establishment of policies and procedures that address performance evaluation, compensation, and advancement (including incentive systems) with regard to its personnel in order to demonstrate the firm's overarching commitment to quality

b. Assignment of management responsibilities so that commercial considerations do not override the quality of the work performed

c. Provision of sufficient and appropriate resources for the development, documentation, and support of its quality control policies and procedures

Assigning Operational Responsibility for the Firm's System of Quality Control (Ref: par. .20)

.A6 Sufficient and appropriate experience and ability enables the person or persons responsible for the firm's system of quality control to identify and understand quality control issues and to develop appropriate policies and procedures. Necessary authority enables the person or persons to implement those policies and procedures.

Relevant Ethical Requirements

Compliance With Relevant Ethical Requirements (Ref: par. .21)

.A7 The AICPA Code of Professional Conduct establishes the fundamental principles of professional ethics, which include the following:

- Responsibilities
- The public interest
- Integrity
- Objectivity and independence
- Due care
- Scope and nature of services

.A8 Independence requirements are set forth in the " Independence Rule" and related interpretations of the AICPA Code of Professional Conduct and the rules of state boards of accountancy and applicable regulatory agencies. Guidance on threats to independence and safeguards to mitigate such threats involving matters that are not explicitly addressed in the Code of Professional Conduct are set forth in the "Conceptual Framework for Independence" (ET sec. 1.210.010). [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

.A9 The fundamental principles are reinforced, in particular, by the following:

- The leadership of the firm
- Education and training
- Monitoring
- A process for dealing with noncompliance

Written Confirmation (Ref: par. .25)

.A10 Written confirmation may be in paper or electronic form. By obtaining confirmation and taking appropriate action on information indicating noncompliance, the firm demonstrates the importance that it attaches to independence and keeps the issue current for, and visible to, its personnel.

Acceptance and Continuance of Client Relationships and Specific Engagements

Competence, Capabilities, and Resources (Ref: par. .27a)

.A11 Consideration of whether the firm has the competence, capabilities, and resources to undertake a new engagement from a new or an existing client involves reviewing the specific requirements of the engagement and the existing partner and staff profiles at all relevant levels, including whether

- firm personnel have knowledge of relevant industries or subject matters or the ability to effectively gain the necessary knowledge;
- firm personnel have experience with relevant regulatory or reporting requirements or the ability to effectively gain the necessary competencies;
- the firm has sufficient personnel with the necessary competence and capabilities;
- specialists are available, if needed;
- individuals meeting the criteria and eligibility requirements to perform an engagement quality control review are available, when applicable; and
- the firm is able to complete the engagement within the reporting deadline.

Integrity of a Client (Ref: par. .27c)

.A12 Matters to consider regarding the integrity of a client include, for example, the following:

- The identity and business reputation of the client's principal owners, key management, and those charged with governance
- The nature of the client's operations, including its business practices
- Information concerning the attitude of the client's principal owners, key management, and those charged with governance toward such matters as internal control or aggressive interpretation of accounting standards
- Indications of an inappropriate limitation in the scope of the work
- Indications that the client might be involved in money laundering or other criminal activities
- The reasons for the proposed appointment of the firm and nonreappointment of the previous firm

The extent of knowledge that a firm will have regarding the integrity of a client will generally grow within the context of an ongoing relationship with that client.

.A13 Sources of information on such matters obtained by the firm may include the following:

- Communications with existing or previous providers of professional accountancy services to the client, in accordance with relevant ethical requirements, and discussions with other third parties
- Inquiry of other firm personnel or third parties, such as bankers, legal counsel, and industry peers
- Background searches of relevant databases

Continuance of a Client Relationship (Ref: par. .28a)

.A14 Deciding whether to continue a client relationship includes consideration of significant issues that have arisen during the current or previous engagements and their implications for continuing the relationship.

For example, a client may have started to expand its business operations into an area where the firm does not possess, and cannot obtain, the necessary expertise.

Obtaining an Understanding With the Client (Ref: par. .29)

.A15 Professional standards applicable to the engagement may contain requirements for obtaining a written understanding with the client.

Withdrawal (Ref: par. .30)

.A16 Policies and procedures on withdrawal from an engagement or from both the engagement and the client relationship may address issues that include the following:

- Discussing with the appropriate level of the client's management and those charged with governance the appropriate action that the firm might take based on the relevant facts and circumstances
- If the firm determines that it is appropriate to withdraw, discussing with the appropriate level of the client's management and those charged with governance withdrawal from the engagement or from both the engagement and the client relationship and the reasons for the withdrawal
- Considering whether there is a professional, legal, or regulatory requirement for the firm to remain in place or for the firm to report the withdrawal from the engagement or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities
- Documenting significant matters, consultations, conclusions, and the basis for the conclusions

Human Resources (Ref: par. .31)

.A17 Personnel issues relevant to the firm's policies and procedures related to human resources include, for example, the following:

- Recruitment and hiring, if applicable
- Performance evaluation, compensation, and advancement
- Determining competencies and capabilities, including time to perform assignments
- Professional development
- The estimation of personnel needs

Effective recruitment processes and procedures help the firm select individuals of integrity who have the capacity to develop the competence and capabilities necessary to perform the firm's work and possess the appropriate characteristics to enable them to perform competently. Examples of such characteristics may include meeting minimum academic requirements established by the firm, maturity, integrity, and leadership traits.

.A18 *Competencies and capabilities* are the knowledge, skills, and abilities that qualify personnel to perform an engagement covered by this section. Competencies and capabilities are not measured by periods of time because such a quantitative measurement may not accurately reflect the kinds of experiences

gained by personnel in any given time period. Accordingly, for purposes of this section, a measure of overall competency is qualitative rather than quantitative.

.A19 Competence can be developed through a variety of methods; these methods include, for example, the following:

- Professional education
- Continuing professional development, including training
- Work experience
- Mentoring by more experienced staff, such as other members of the engagement team
- Independence education for personnel who are required to be independent

.A20 The continuing competence of the firm's personnel depends, to a significant extent, on an appropriate level of continuing professional development so that personnel maintain their knowledge and capabilities. Effective policies and procedures emphasize the need for all levels of firm personnel to participate in general and industry-specific continuing professional education (CPE) and other professional development activities that enable them to fulfill responsibilities assigned and to satisfy applicable CPE requirements of the AICPA and regulatory agencies. Effective policies and procedures also place importance on passing the Uniform CPA Examination. The firm may provide the necessary training resources and assistance to enable personnel to develop and maintain the required competence and capabilities.

.A21 The firm may use a suitably qualified external person, for example, when internal technical and training resources are unavailable.

.A22 Effective performance evaluation, compensation, and advancement procedures give due recognition and reward to the development and maintenance of competence and commitment to ethical principles. Steps that a firm may take in developing and maintaining competence and commitment to ethical principles include the following:

- Making personnel aware of the firm's expectations regarding performance and ethical principles
- Providing personnel with an evaluation of, and counseling on, performance, progress, and career development
- Helping personnel understand that their compensation and advancement to positions of greater responsibility depend upon, among other things, performance quality and adherence to ethical principles and that failure to comply with the firm's policies and procedures may result in disciplinary action.

Considerations Specific to Smaller Firms

.A23 The size and circumstances of the firm are important considerations in determining the structure of the firm's performance evaluation process. Smaller firms, in particular, may employ less formal methods of evaluating the performance of their personnel.

The Relationship of the Competency Requirement of the Uniform Accountancy Act to the Human Resource Element of Quality Control

.A24 CPAs are required to follow the accountancy laws of the individual licensing jurisdictions in the United States that govern public practice. These jurisdictions may have adopted, in whole or in part, the Uniform Accountancy Act (UAA), which is a model legislative statute, including related administrative rules, designed by the AICPA and the National Association of State Boards of Accountancy to provide a uniform approach to the regulation of the accounting profession. The UAA provides that "[a]ny individual licensee ... who is responsible for supervising attest or compilation services and signs or authorizes someone to sign the accountant's report on the financial statements on behalf of the firm, shall meet the competency requirements set out in the professional standards for such services." A firm's compliance with this section is intended to enable a practitioner who performs accounting and auditing services on the firm's behalf to meet the competency requirement referred to in the UAA. [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

Assignment of Engagement Teams

Engagement Partners (Ref: par. .33)

.A25 In most cases, an engagement partner will have gained the necessary competencies through relevant and appropriate experience in engagements covered by this section. In some cases, however, an engagement partner may have obtained the necessary competencies through disciplines other than public practice, such as in relevant industry, governmental, and academic positions. When necessary, the experience of the engagement partner may be supplemented by CPE and consultation. The following are examples:

- An engagement partner whose recent experience has consisted primarily in providing tax services may acquire the competencies necessary in the circumstances to perform a compilation or review engagement by obtaining relevant CPE.

- An engagement partner whose experience consists of performing review and compilation engagements may be able to obtain the necessary competencies to perform an audit by becoming familiar with the industry in which the client operates, obtaining CPE relating to auditing, using consulting sources during the course of performing the audit engagement, or any combination of these.

- A person in academia might obtain the necessary competencies to perform engagements covered by this section by (*a*) obtaining specialized knowledge through teaching or authorship of research projects or similar papers and (*b*) performing a rigorous self-study program or by engaging a consultant to assist on such engagements.

[Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

.A26 The characteristics of a particular client, industry, and the kind of service being provided determine the nature and extent of competencies established by a firm that are expected of the engagement partner. For example

- the competencies expected of an engagement partner to compile financial statements would be different than those expected of a practitioner engaged to review or audit financial statements.

- supervising engagements and signing or authorizing others to sign reports for clients in certain industries or engagements, such as financial services, governmental, or employee benefit plan engagements, would require different competencies than those expected in performing attest services for clients in other industries.

- the engagement partner for an attestation engagement to examine the effectiveness of an entity's internal control over financial reporting that is integrated with an audit of financial statements would be expected to have technical proficiency in understanding and evaluating the effectiveness of controls, whereas an engagement partner of an attestation engagement to examine investment performance statistics would be expected to have different competencies, including an understanding of the subject matter of the underlying assertion.

.A27 In practice, the competencies necessary for the engagement partner are broad and varied in both their nature and number. Competencies include the following, as well as other competencies as necessary in the circumstances:

- *Understanding of the role of a system of quality control and the Code of Professional Conduct*. An understanding of the role of a firm's system of quality control and the AICPA's Code of Professional Conduct, both of which play critical roles in assuring the integrity of the various kinds of reports.

- *Understanding of the service to be performed*. An understanding of the performance, supervision, and reporting aspects of the engagement. This understanding is usually gained through actual participation under appropriate supervision in that type of engagement.

- *Technical proficiency*. An understanding of the applicable professional standards, including those standards directly related to the industry in which a client operates, and the kinds of transactions in which a client engages.

- *Familiarity with the industry*. An understanding of the industry in which a client operates to the extent required by professional standards applicable to the kind of service being performed. In performing an audit or review of financial statements, this understanding would include an industry's organization and operating characteristics sufficient to identify areas of high or unusual risk associated with an engagement and to evaluate the reasonableness of industry-specific estimates.

- *Professional judgment*. Skills that indicate sound professional judgment. In performing engagements covered by this section, such skills would typically include the ability to exercise professional skepticism and identify areas requiring special consideration, including, for example, the evaluation of the reasonableness of estimates and representations made by management and the determination of the kind of report appropriate in the circumstances.

- *Understanding the organization's IT systems*. A sufficient understanding of how the organization is dependent on, or enabled by, information technologies and the manner in which the information systems are used to record and maintain financial information to determine when involvement of an IT professional is necessary for an audit engagement.

Interrelationship of Competencies and Other Elements of a Firm's System of Quality Control

.A28 The competencies previously listed are interrelated and gaining one particular competency may be related to achieving another. For example, familiarity with the client's industry interrelates with a practitioner's ability to make professional judgments relating to the client.

.A29 In establishing policies and procedures related to the nature of competencies needed by the engagement partner of an engagement, a firm may consider the requirements of policies and procedures established for other elements of quality control. For example, a firm might consider its requirements related to engagement performance in determining the nature of competency requirements that describe the degree of technical proficiency necessary in a given set of circumstances.

.A30 Policies and procedures may include systems to monitor the workload and availability of engagement partners so as to enable these individuals to have sufficient time to adequately discharge their responsibilities.

Engagement Teams (Ref: par. .34)

.A31 The firm's assignment of engagement teams and the determination of the level of supervision required include, for example, consideration of the engagement team's

- understanding of, and practical experience with, engagements of a similar nature and complexity through appropriate training and participation;
- understanding of professional standards and legal and regulatory requirements;
- technical knowledge and expertise, including knowledge of relevant IT;
- knowledge of relevant industries in which the clients operate;
- ability to apply professional judgment; and
- understanding of the firm's quality control policies and procedures.

Generally, as the ability and experience levels of assigned staff increase, the need for direct supervision decreases.

Engagement Performance

Consistency in the Quality of Engagement Performance (Ref: par. .35a)

.A32 The firm promotes consistency in the quality of engagement performance through its policies and procedures. This is often accomplished through written or electronic manuals, software tools or other forms of standardized documentation, and industry or subject matter-specific guidance materials. Matters addressed may include the following:

- How engagement teams are briefed on the engagement to obtain an understanding of the objectives of their work
- Processes for complying with applicable engagement standards

- Processes of engagement supervision, staff training, and mentoring
- Methods of reviewing the work performed, the significant judgments made, and the type of report being issued
- Appropriate documentation of the work performed and of the timing and extent of the review
- Processes to keep all policies and procedures current

.A33 Appropriate teamwork and training assist less experienced members of the engagement team to clearly understand the objectives of the assigned work.

Supervision (Ref: par. .35b)

.A34 Engagement supervision includes the following:

- Tracking the progress of the engagement
- Considering the competence and capabilities of individual members of the engagement team, whether they have sufficient time to carry out their work, whether they understand their instructions, and whether the work is being carried out in accordance with the planned approach to the engagement
- Addressing significant findings and issues arising during the engagement, considering their significance, and modifying the planned approach appropriately
- Identifying matters for consultation or consideration by more experienced engagement team members during the engagement

Review (Ref: par. .35c)

.A35 A review consists of consideration of whether

- the work has been performed in accordance with professional standards and applicable legal and regulatory requirements;
- significant findings and issues have been raised for further consideration;
- appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
- the nature, timing, and extent of the work performed is appropriate and without need for revision;
- the work performed supports the conclusions reached and is appropriately documented;
- the evidence obtained is sufficient and appropriate to support the report; and
- the objectives of the engagement procedures have been achieved.

Consultation (Ref: par. .37)

.A36 Consultation includes discussion at the appropriate professional level with individuals within or outside the firm who have relevant specialized expertise.

.A37 Consultation uses appropriate research resources, as well as the collective experience and technical expertise of the firm. Consultation helps promote quality and improves the application of professional judgment. Appropriate recognition of consultation in the firm's policies and procedures helps promote a culture in which consultation is recognized as a strength and personnel are encouraged to consult on difficult or contentious issues.

.A38 Effective consultation on significant technical, ethical, and other matters within the firm or, when applicable, outside the firm can be achieved when those consulted

- are given all the relevant facts that will enable them to provide informed advice and
- have appropriate knowledge, authority, and experience

and when conclusions resulting from consultations are appropriately documented and implemented.

.A39 Documentation that is sufficiently complete and detailed of consultations with other professionals that involve difficult or contentious matters contributes to an understanding of

- the issue on which consultation was sought and
- the results of the consultation, including any decisions made, the basis for those decisions, and how they were implemented.

Considerations Specific to Smaller Firms

.A40 A firm needing to consult externally may take advantage of advisory services provided by the following:

- Other firms
- Professional and regulatory bodies
- Commercial organizations that provide relevant quality control services

Before contracting for such services, consideration of the competence and capabilities of the external provider helps the firm determine whether the external provider is suitably qualified for that purpose.

Engagement Quality Control Review

Criteria for an Engagement Quality Control Review (Ref: par. .38)

.A41 The structure and nature of the firm's practice are important considerations in establishing criteria for determining which engagements are to be subject to an engagement quality control review. Such criteria may include, for example, the following:

- The nature of the engagement, including the extent to which it involves a matter of public interest

- The identification of unusual circumstances or risks in an engagement or class of engagements
- Whether laws or regulations require an engagement quality control review

Nature, Timing, and Extent of the Engagement Quality Control Review (Ref: par. .40–.41)

.A42 An engagement quality control review may include consideration of the following:

- The engagement team's evaluation of the firm's independence in relation to the specific engagement
- Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters and the conclusions arising from those consultations
- Whether documentation selected for review reflects the work performed in relation to the significant judgments and supports the conclusions reached

.A43 If the engagement quality control review is completed after the report is dated and identifies instances where additional procedures are needed or additional evidence is required, the date of the report is changed to the date when the additional procedures have been satisfactorily completed or the additional evidence has been obtained, in accordance with the professional standards applicable to the engagement.

.A44 Conducting the engagement quality control review in a timely manner at appropriate stages during the engagement allows significant issues to be promptly resolved to the engagement quality control reviewer's satisfaction before the report is released.

.A45 The extent of the engagement quality control review may depend upon, among other things, the complexity of the engagement and the risk that the report might not be appropriate in the circumstances. The performance of an engagement quality control review does not reduce the responsibilities of the engagement partner.

.A46 Other matters relevant to evaluating the significant judgments made by the engagement team that may be considered in an engagement quality control review for audits, as well as reviews of financial statements and other assurance and related services engagements, include the following:

- Significant risks identified during the engagement and the responses to those risks
- Judgments made, particularly with respect to materiality and significant risks
- The significance and disposition of corrected and uncorrected misstatements identified during the engagement
- The matters to be communicated to management and those charged with governance and, when applicable, other parties, such as regulatory bodies

.A47 When the engagement quality control reviewer makes recommendations that the engagement partner does not accept and the matter is not resolved to the reviewer's satisfaction, the firm's procedures for dealing with differences of opinion apply.

Criteria for the Eligibility of Engagement Quality Control Reviewers

Sufficient and Appropriate Technical Expertise, Experience, and Authority (Ref: par. .42*a*)

.A48 What constitutes sufficient and appropriate technical expertise, experience, and authority depends on the circumstances of the engagement.

Consultation With the Engagement Quality Control Reviewer (Ref: par. .42*b*)

.A49 The engagement partner may consult the engagement quality control reviewer at any stage during the engagement (for example, to establish that a judgment made by the engagement partner will be acceptable to the engagement quality control reviewer). Such consultation avoids identification of differences of opinion at a late stage of the engagement and does not necessarily impair the engagement quality control reviewer's eligibility to perform the role. When the nature and extent of the consultations become significant, the reviewer's objectivity may be impaired unless both the engagement team and the reviewer are careful to maintain the reviewer's objectivity. When this is not possible, another individual within the firm or a suitably qualified external person may be appointed to take on the role of either the engagement quality control reviewer or the person to be consulted on the engagement.

Objectivity of the Engagement Quality Control Reviewer (Ref: par. .43–.44)

Considerations Specific to Smaller Firms

.A50 Suitably qualified external persons may be contracted when sole practitioners or small firms identify engagements requiring engagement quality control reviews and no person in the firm meets the eligibility requirements for an engagement quality control reviewer. Alternatively, some sole practitioners or small firms may wish to use other firms to facilitate engagement quality control reviews. When the firm contracts suitably qualified external persons or other firms, the requirements in paragraphs .43–.44 and the guidance in paragraph .A49 apply.

Differences of Opinion (Ref: par. .46)

.A51 Effective procedures encourage identification of differences of opinion at an early stage, provide clear guidelines about the successive steps to be taken thereafter, and require documentation regarding the resolution of the differences and the implementation of the conclusions reached.

.A52 Procedures to resolve such differences may include consulting with another practitioner or firm or a professional or regulatory body.

Engagement Documentation

Completion of the Assembly of Final Engagement Files (Ref: par. .49)

.A53 Professional standards, law, or regulation may prescribe the time limits by which the assembly of final engagement files for specific types of engagements is to be completed. When no such time limits are prescribed, paragraph .49 requires the firm to establish time limits that reflect the need to complete the assembly of final engagement files on a timely basis.

.A54 When two or more different reports are issued regarding the same subject matter information of an entity, the firm's policies and procedures relating to time limits for the assembly of final engagement files address each report as if it were for a separate engagement. This may, for example, be the case when the firm issues an auditor's report on financial information prepared in accordance with generally accepted

accounting principles and, at a subsequent date, an auditor's report on the same financial information prepared in accordance with a special purpose framework for regulatory purposes.

Confidentiality, Safe Custody, Integrity, Accessibility, and Retrievability of Engagement Documentation (Ref: par. .50)

.A55 Relevant ethical requirements establish an obligation for the firm's personnel to observe at all times the confidentiality of information contained in engagement documentation, unless specific client authority has been given to disclose information or a legal or professional duty exists to do so. Specific laws or regulations may impose additional obligations on the firm's personnel to maintain client confidentiality, particularly when data of a personal nature are concerned.

.A56 Whether engagement documentation is in paper, electronic, or other media, the integrity, accessibility, or retrievability of the underlying data may be compromised if the documentation could be altered, added to, or deleted without the firm's knowledge or if it could be permanently lost or damaged. Accordingly, controls that the firm designs and implements to avoid unauthorized alteration or loss of engagement documentation may include those that

- enable the determination of when and by whom engagement documentation was prepared or reviewed;
- protect the integrity of the information at all stages of the engagement, especially when the information is shared within the engagement team or transmitted to other parties via electronic means;
- prevent unauthorized changes to the engagement documentation; and
- allow access to the engagement documentation by the engagement team and other authorized parties, as necessary, to properly discharge their responsibilities.

.A57 Controls that the firm designs and implements to maintain the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation may include the following:

- The use of a password by engagement team members and data encryption to restrict access to electronic engagement documentation to authorized users
- Appropriate back-up routines for electronic engagement documentation at appropriate stages during the engagement
- Procedures for properly distributing engagement documentation to the team members at the start of the engagement, processing it during the engagement, and collating it at the end of the engagement
- Procedures for restricting access to, and enabling proper distribution and confidential storage of, hard copy engagement documentation

.A58 For practical reasons, original paper documentation may be electronically scanned or otherwise copied to another media for inclusion in engagement files. In such cases, the firm's procedures designed to maintain the integrity, accessibility, and retrievability of the documentation may include requiring the engagement teams to

- generate scanned copies that reflect the entire content of the original paper documentation, including manual signatures, cross-references, and annotations.

- integrate the scanned copies into the engagement files, including indexing and signing off on the scanned copies as necessary.

- enable the scanned copies to be retrieved and printed as necessary.

There may be legal, regulatory, or other reasons for a firm to retain original paper documentation.

Retention of Engagement Documentation (Ref: par. .51)

.A59 The needs of the firm for retention of engagement documentation and the period of such retention will vary with the nature of the engagement and the firm's circumstances (for example, whether the engagement documentation is needed to provide a record of matters of continuing significance to future engagements). The retention period may also depend on other factors, such as whether professional standards, law, or regulation prescribe specific retention periods for certain types of engagements or whether generally accepted retention periods exist in the absence of specific legal or regulatory requirements.

.A60 In the specific case of audit engagements, the retention period would be no shorter than five years from the report release date. [fn 3]

.A61 Procedures that the firm may adopt for retention of engagement documentation include those that enable the requirements of paragraph .51 to be met during the retention period, such as, for example, procedures to

- enable the retrieval of, and access to, the engagement documentation during the retention period, particularly in the case of electronic documentation because the underlying technology may be upgraded or changed over time.

- provide, when necessary, a record of changes made to engagement documentation after the assembly of engagement files has been completed.

- enable authorized external parties to access and review specific engagement documentation for quality control or other purposes.

Ownership of Engagement Documentation

.A62 Unless otherwise specified by law or regulation, engagement documentation is the property of the firm. The firm may, at its discretion, make portions of, or extracts from, engagement documentation available to clients, provided that such disclosure does not undermine the validity of the work performed or, in the case of assurance engagements, the independence of the firm or its personnel.

[fn 3] Paragraph .17 of AU-C section 230, *Audit Documentation*. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Monitoring

Monitoring the Firm's Quality Control Policies and Procedures (Ref: par. .52)

.A63 The purpose of monitoring compliance with quality control policies and procedures is to assess, for the system of quality control as a whole, whether the firm is achieving the objective described in paragraph .12 through an evaluation of the following:

- Adherence to professional standards and applicable legal and regulatory requirements
- Whether the system of quality control has been appropriately designed and effectively implemented
- Whether the firm's quality control policies and procedures have been operating effectively so that reports that are issued by the firm are appropriate in the circumstances

The evaluation may identify circumstances that necessitate changes to, or improve compliance with, the firm's policies and procedures to provide the firm with reasonable assurance that its system of quality control is effective.

.A64 Ongoing consideration and evaluation of the system of quality control may include matters such as the following:

- Review of selected administrative and personnel records pertaining to the quality control elements
- Review of engagement documentation, reports, and clients' financial statements
- Discussions with the firm's personnel
- Determination of corrective actions to be taken and improvements to be made in the system, including providing feedback into the firm's policies and procedures relating to education and training
- Communication to appropriate firm personnel of weaknesses identified in the system, in the level of understanding of the system, or compliance with the system
- Follow-up by appropriate firm personnel so that necessary modifications are promptly made to the quality control policies and procedures

.A65 Monitoring procedures also may include an assessment of the following:

- The appropriateness of the firm's guidance materials and any practice aids
- New developments in professional standards and legal and regulatory requirements and how they are reflected in the firm's policies and procedures, when appropriate
- Written confirmation of compliance with policies and procedures on independence
- The effectiveness of continuing professional development, including training

- Decisions related to acceptance and continuance of client relationships and specific engagements
- Firm personnel's understanding of the firm's quality control policies and procedures and implementation thereof

.A66 Some of the monitoring procedures discussed previously may be accomplished through the performance of the following:

- Engagement quality control review
- Review of engagement documentation, reports, and clients' financial statements for selected engagements after the report release date
- Inspection procedures

Reviews of the work or report when performed by engagement team members prior to the date of the report are not monitoring procedures.

.A67 The need for, and extent of, inspection procedures depends, in part, on the existence and effectiveness of the other monitoring procedures. The nature of inspection procedures varies based on the firm's quality control policies and procedures and the effectiveness and results of other monitoring procedures.

.A68 The inspection of a selection of completed engagements may be performed on a cyclical basis. For example, engagements selected for inspection may include at least one engagement for each engagement partner over an inspection cycle that spans three years. The manner in which the inspection cycle is organized, including the timing of selection of individual engagements, depends on many factors, such as the following:

- The size of the firm
- The number and geographical location of offices
- The results of previous monitoring procedures
- The degree of authority of both personnel and office (for example, whether individual offices are authorized to conduct their own inspections or whether only the head office may conduct them)
- The nature and complexity of the firm's practice and organization
- The risks associated with the firm's clients and specific engagements

.A69 Inspection procedures with respect to the engagement performance element of a quality control system are particularly appropriate in a firm with more than a limited number of management-level individuals responsible for the conduct of its accounting and auditing practice.

.A70 The inspection process involves the selection of individual engagements, some of which may be selected without prior notification to the engagement team. In determining the scope of the inspections, the firm may take into account the scope or conclusions of a peer review or regulatory inspections.

The Relationship of Peer Review to Monitoring

.A71 A peer review does not substitute for all monitoring procedures. However, because the objective of a peer review is similar to that of inspection procedures, a firm's quality control policies and procedures may provide that a peer review conducted under standards established by the AICPA may substitute for the inspection of engagement documentation, reports, and clients' financial statements for some or all engagements for the period covered by the peer review.

Considerations Specific to Smaller Firms

.A72 In small firms with a limited number of persons with sufficient and appropriate experience and authority in the firm, monitoring procedures may need to be performed by some of the same individuals who are responsible for compliance with the firm's quality control policies and procedures. This includes review of engagement working papers, reports, and clients' financial statements by the engagement partner or other qualified personnel after the report release date. To effectively monitor one's own compliance with the firm's policies and procedures, it is necessary that an individual be able to critically review his or her own performance, assess his or her own strengths and weaknesses, and maintain an attitude of continual improvement. Changes in conditions and the environment within the firm (such as obtaining clients in an industry not previously serviced or significantly changing the size of the firm) may indicate the need to have quality control policies and procedures monitored by another qualified individual.

.A73 Having an individual inspect his or her own compliance with a quality control system may be less effective than having such compliance inspected by another qualified individual. When one individual inspects his or her own compliance, the firm has a higher risk that noncompliance with policies and procedures will not be detected. Accordingly, a firm with a limited number of persons with sufficient and appropriate experience and authority in the firm may find it beneficial to engage a suitably qualified external person or another firm to perform engagement inspections and other monitoring procedures.

Communicating Deficiencies (Ref: par. .55)

.A74 The reporting of identified deficiencies to individuals other than the relevant engagement partners need not include an identification of the specific engagements concerned, unless such identification is necessary for the proper discharge of the responsibilities of the individuals other than the engagement partners.

Complaints and Allegations

Source of Complaints and Allegations (Ref: par. .60)

.A75 Complaints and allegations of noncompliance with the firm's system of quality control (which do not include those that are clearly frivolous) may originate from within or outside the firm. They may be made by firm personnel, clients, state boards of accountancy, other regulators, or other third parties. They may be received by engagement team members or other firm personnel.

Investigation Policies and Procedures (Ref: par. .61)

.A76 Policies and procedures established for the investigation of complaints and allegations may include, for example, that the partner supervising the investigation

- has sufficient and appropriate experience,

- has authority within the firm, and
- is otherwise not involved in the engagement.

The partner supervising the investigation may involve legal counsel as necessary.

Considerations Specific to Smaller Firms

.A77 In the case of firms with few partners, it may not be practicable for the partner supervising the investigation not to be involved in the engagement. These small firms and sole practitioners may use the services of a suitably qualified external person or another firm to carry out the investigation into complaints and allegations.

Documentation of the System of Quality Control (Ref: par. .62)

.A78 The form and content of documentation evidencing the operation of each of the elements of the system of quality control is a matter of judgment and depends on a number of factors, including the following:

- The size of the firm and the number of offices
- The nature and complexity of the firm's practice and organization

For example, large firms may use electronic databases to document matters such as independence confirmations, performance evaluations, and the results of monitoring inspections.

.A79 Appropriate documentation relating to monitoring includes, for example, the following:

- Monitoring procedures, including the procedure for selecting completed engagements to be inspected
- A record of the evaluation of the following:
  - — Adherence to professional standards and applicable legal and regulatory requirements
  - — Whether the system of quality control has been appropriately designed and effectively implemented
  - — Whether the firm's quality control policies and procedures have been appropriately applied so that the reports that are issued by the firm are appropriate in the circumstances
- Identification of the deficiencies noted, an evaluation of their effect, and the basis for determining whether and what further action is necessary

Considerations Specific to Smaller Firms

.A80 Smaller firms may use more informal methods in the documentation of their systems of quality control, such as manual notes, checklists, and forms.

Exhibit — Comparison of Section 10, *A Firm's System of Quality Control*, and International Standard on Quality Control 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

.A81

This analysis was prepared by the AICPA Audit and Attest Standards staff to highlight substantive differences between section 10, *A Firm's System of Quality Control*, and International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*, and the rationale therefore. This analysis is not authoritative and is prepared for informational purposes only. It has not been acted on or reviewed by the Auditing Standards Board (ASB).

Differences in Language

The ASB has made various changes to the language throughout section 10, as compared with ISQC 1. Such changes have been made to use terms applicable in the United States and to make section 10 easier to read and apply. The ASB believes that such changes will not create differences between the application of ISQC 1 and the application of section 10.

Requirements in Section 10 Not in ISQC 1

Section 10 requires firms to establish policies and procedures providing

- in paragraph .30, for obtaining an understanding with the client regarding the nature, scope, and limitations of the services to be performed.
- in paragraph .33, that personnel selected for advancement have the qualifications necessary for fulfillment of the responsibilities they will be called on to assume.
- in paragraph .44, that although the engagement quality control reviewer is not a member of the engagement team, the engagement quality control reviewer should satisfy the independence requirements relating to the engagements reviewed.
- in paragraph .48, that when differences of opinion exist, a member of the engagement team be able to document that member's disagreement with the conclusions reached, after appropriate consultation.

ISQC 1 does not have equivalent requirements.

Requirements in ISQC 1 Not in Section 10

Paragraph 25 of ISQC 1 requires the firm to establish policies and procedures setting out criteria for determining the need for safeguards to reduce the familiarity threat to an acceptable level when using the same senior personnel on an assurance engagement over a long period of time. The ASB believes that the familiarity threat should not be singled out among other threats to independence.

Paragraph 48(a) of ISQC 1 requires including, on a cyclical basis, inspection of at least one completed engagement for each engagement partner as a monitoring procedure. The ASB believes that this requirement is overly prescriptive and that a risk-based approach to inspections is more appropriate.

Requirements in ISQC 1 Revised in Section 10

Paragraph .41 of section 10 requires that when an engagement quality control review is performed, the engagement quality control review be completed before the report is released. Paragraph 36 of ISQC 1 requires that the quality control review be completed before the report is dated. The ASB believes that an engagement quality control review is an independent review of the engagement team's significant judgments, including the date selected by the engagement team to date the report. As noted in the application material to section 10, when the engagement quality control review results in additional procedures having to be performed, the date of the report would be changed.

Paragraph 48(c) of ISQC 1 requires that those performing the engagement or the engagement quality control review are not involved in inspecting the engagements. Paragraph .53*c* of section 10, consistent with the requirement in paragraph 100 of Statement on Quality Control Standards No. 7, *A Firm's System of Quality Control*, requires that performance of monitoring of the firm's system of quality control be assigned to qualified individuals. Paragraph .A72 of section 10 notes that in small firms with a limited number of persons with sufficient and appropriate experience and authority in the firm, monitoring procedures may need to be performed by some of the same individuals who are responsible for compliance with the firm's quality control policies and procedures. The ASB concluded that it was not necessary to change existing practice because in the United States, the peer review process provides a safeguard and provides evidence that the monitoring procedures are effective.

Paragraph A49 of ISQC 1 references the requirement in paragraph 40 of ISQC 1 to establish policies and procedures to maintain the objectivity of the engagement quality control reviewer and states, "Accordingly, such policies and procedures provide ...." The ASB believes that notwithstanding its placement as application material, the language is indicative of a requirement and, accordingly, has included a requirement for the provision of these specific policies and procedures in paragraph .44 of section 10. The ASB believes this will not create a difference in the application of ISQC 1 and the application of section 10.

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Appendix B

"Alternative Practice Structures" Interpretation (ET Sec. 1.220.020)

1.220.020 Alternative Practice Structures

.01 *Members* practicing public accounting in nontraditional practice structures (alternative practice structures [APS]) should apply this interpretation to determine whether they are in compliance with the "Independence Rule" [1.200.001].

.02 All such structures must be organized in a form that complies with applicable laws, rules, and regulations, the "Form of Organization and Name Rule" [1.800.001] and the related "Alternative Practice Structures" interpretation [1.810.050] of the "Form of Organization and Name Rule."

.03 For example, in an APS, a substantial piece of the nonattest portion of a *member's* practice may be conducted under public or private ownership, and the attest portion of the practice may be conducted through a separate *firm* that the *member* owns and *controls*.

Terminology

.04 The following terms are defined solely for the purpose of applying this interpretation:

a. APS is a form of organization in which a *firm* that provides attest services is closely aligned with another public or private organization that performs other *professional services*.

b. A covered member includes both employed and leased individuals who meet the definition of a *covered member*.

c. The term direct superiors includes those persons so closely associated with a *partner* or *manager* who is a covered member that such persons can directly control the *partner's* or *manager's* activities. For this purpose, a person who can directly control is the immediate superior of the *partner* or *manager* who has the power to direct the activities of that person so as to be able to directly or indirectly (for example, through another entity over which the direct superior can exercise significant influence) derive a benefit from that person's activities. An example is the person who has day-to-day responsibility for the activities of the *partner* or *manager* and is in a position to recommend promotions and compensation levels. This group of persons is so closely aligned through direct reporting relationships that their interests seem to be inseparable.

d. Indirect superiors are not connected with *partners* and *managers* who are covered members through direct reporting relationships; rather, they are one or more levels above direct superiors of covered members (that is, there always is a level in between). Generally, this starts with persons in an organization structure to whom direct superiors report and go up the line from there. Indirect superiors also include the *immediate family* of indirect superiors.

e. Other public company entities include the public company and all entities consolidated in the public company *financial statements* that are not subject to the "Independence Rule" [1.200.001] and its *interpretations* in their entirety.

f. Significant influence is having the ability to exercise significant influence over the financial, operating, or accounting policies of the entity by, for example

i. being connected with the entity as a promoter, an underwriter, a voting trustee, a general partner, or a director;

ii. being in a policy-making position, such as chief executive officer, chief operating officer, chief financial officer, or chief accounting officer; or

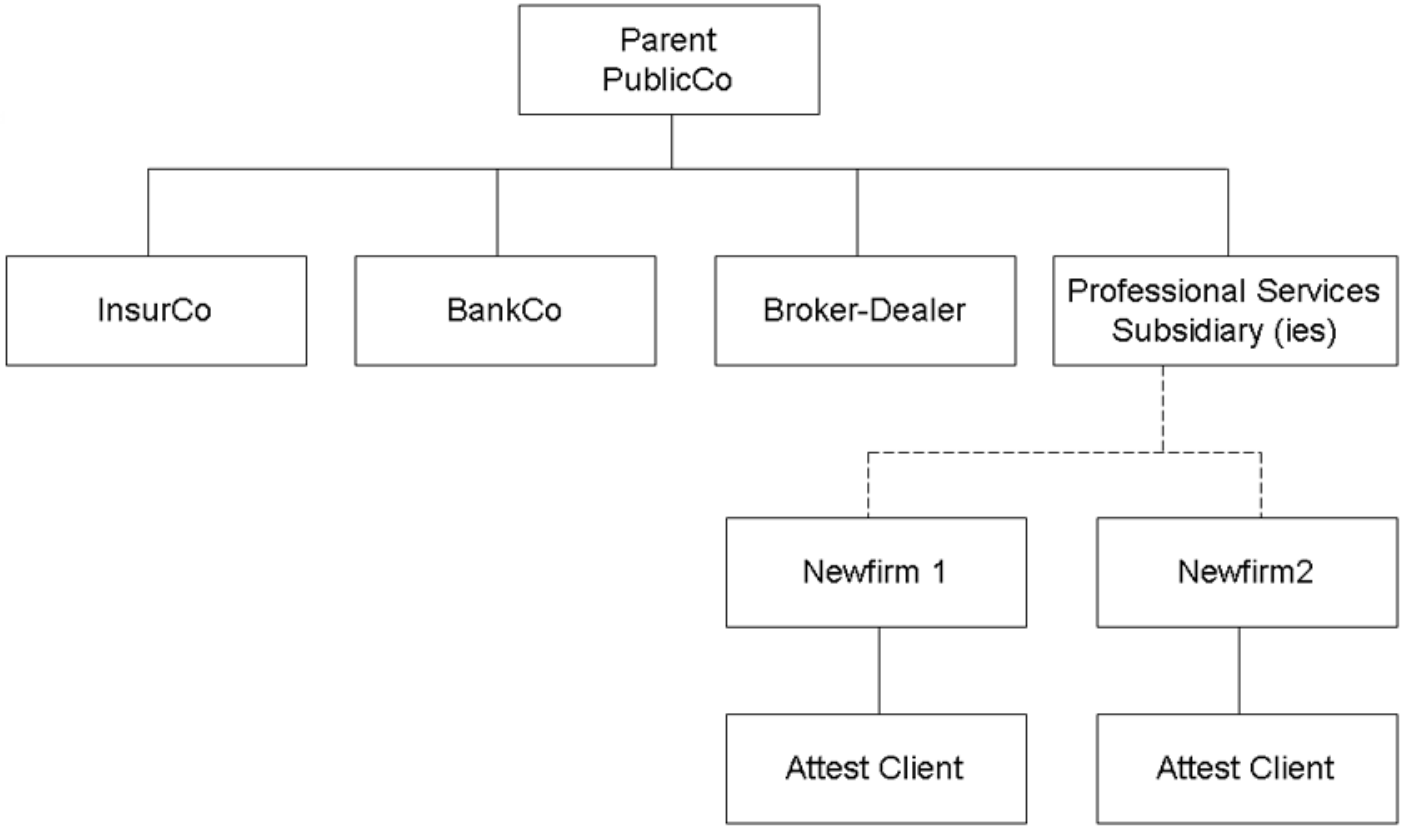
iii. meeting the criteria in Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 323-10-15 to determine the ability of an investor to exercise such influence with respect to an entity.

APS Model

.05 The APS described in paragraphs .06–.07 in this section and the related chart provides an example of a structure in use at the time that this interpretation was developed. Many of the references in this interpretation are to the example, but *members* should apply the concepts in spirit and substance to variations of the example structure as they develop.

.06 The example APS in this interpretation is one in which an existing CPA practice (Oldfirm) is sold by its owners to another (possibly public) entity (PublicCo). PublicCo has subsidiaries or divisions, such as a bank, an insurance company, or a broker-dealer. It also has one or more professional service subsidiaries (PSS) or divisions that offer nonattest services (for example, tax, personal financial planning, and management consulting) to *clients*. The owners and employees of Oldfirm become employees of one of PublicCo's subsidiaries or divisions and may provide those nonattest services. In addition, the owners of Oldfirm form a new CPA *firm* (Newfirm) to provide attest services. CPAs, including the former owners of Oldfirm, own a majority of Newfirm (with regard to voting and financial interests). Attest services are performed by Newfirm and supervised by its owners. The arrangement between Newfirm and PublicCo (or one of its subsidiaries or divisions) includes the lease of employees, office space, and equipment; the performance of back-office functions, such as billing and collections; and advertising. Newfirm pays a negotiated amount for these services.

.07 The chief executive of the local office of the PSS where the *partners* of Newfirm are employed would be a direct superior. The chief executive of the PSS itself would be an indirect superior, and there may be indirect superiors in between, such as a regional chief executive of all PSS offices within a geographic area.



Interpretation

.08 The "Independence Rule" [1.200.001] and *interpretations* normally extend only to those persons and entities included in the definition of *covered members*. However, in an APS environment, the self-interest, management participation, self-review, advocacy, or undue influence *threats* to a covered member's compliance with the "Independence Rule" may not be at an *acceptable level* unless certain *safeguards* are implemented by other individuals or entities.

.09 *Threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level*, could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired* when the following individuals or entities fail to apply the "Independence Rule" and *interpretations* with respect to *attest clients* of Newfirm:

a. Covered members of Newfirm

b. Direct superiors of any *partner* or *manager* who is a covered member of Newfirm and entities within the APS over which such individuals can exercise *significant influence*

.10 In addition, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level*, could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired* in the following circumstances:

a. Indirect superiors and other public company entities have a material relationship with an *attest client* of Newfirm that is prohibited by the "Overview of Financial Interests" interpretation [1.240.010], the "Trustee or Executor" interpretation [1.245.010], the "Loans" interpretation

[1.260.010], or the "Joint Closely Held Investments" interpretation [1.265.020] of the "Independence Rule" (for example, investments, *loans*, and so on). In making the test for materiality for financial relationships of an indirect superior, all the financial relationships with an *attest client* held by that person should be aggregated and, to determine materiality, assessed in relation to the person's net worth. In making the materiality test for financial relationships of other public company entities, all the financial relationships with an *attest client* held by such entities should be aggregated and, to determine materiality, assessed in relation to the consolidated *financial statements* of PublicCo.

b. Any other public company entity over which an indirect superior has direct responsibility has a financial relationship with an *attest client* during the *period of the professional engagement* that is material in relation to the other public company entity's *financial statements*.

c. Financial relationships of indirect superiors or other public company entities allow such persons or entities to exercise significant influence over the *attest client* during the *period of the professional engagement.* In making the test for significant influence, financial relationships of all indirect superiors and other public company entities should be aggregated.

d. Other public company entities or any of their employees are connected with an *attest client* of Newfirm as a promoter, an underwriter, a voting trustee, a director, or an officer during the *period of the professional engagement* or during the period covered by the *financial statements*.

.11 Indirect superiors and other public company entities may provide services to an *attest client* of Newfirm that would *impair independence* if performed by Newfirm, except as noted in paragraph .10*d*.

.12 When Newfirm and its *partners* and professional employees perform *attest engagements* for PublicCo or any of its subsidiaries or divisions, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* through the application of *safeguards*. Accordingly, *independence* would be *impaired*.

.13 If an *attest client* of Newfirm holds an investment in PublicCo that is material to the *attest client* or that allows the *attest client* to exercise significant influence over PublicCo during the *period of the professional engagement, threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* through the application of *safeguards*. Accordingly, *independence* would be *impaired*.

.14 When making referrals of services between Newfirm and any of the entities within PublicCo, a *member* should consider the provisions of the "Conflicts of Interest" interpretation [1.110.010] of the "Integrity and Objectivity Rule" [1.100.001] and the "Alternative Practice Structures" interpretation [1.810.050] of the "Form of Organization and Name Rule" [1.800.001]. [Prior reference: paragraph .16 of ET section 101]