

Peer Review Board Open Session Materials

November 14, 2016

Conference Call

**AICPA Peer Review Board
Open Session Agenda
November 14, 2016
Teleconference**

Date/Time: Monday November 14, 2016 11:00 AM – 12:30 PM (Eastern Time)

Meeting Location: Teleconference

- 1.1 Welcome Attendees and Roll Call of Board** – Mr. Kindem/Mr. Parry
- 1.2 Approval of Modifications of Report and Representation Letter Guidance Changes* – Mr. Pope
- 1.3 Approval of Alternative Practice Structure Supplemental Form for QCPP Compliance and Design Testing* - Mr. Pope
- 1.4 Future Open Session Meetings**
 - A. January 31, 2017 Open session – Naples, FL
 - B. May 12, 2017 Open session – Durham, NC
 - C. August 17, 2017 Open session – Nashville, TN
 - D. September 29, 2017 Open session – Conference call

*- Document Provided

**-Verbal Discussion

***-Document To Be Provided

Approval of Changes to the AICPA Standards for Performing and Reporting on Peer Reviews - Exposure Draft Guidance Changes

Why is this on the Agenda?

The [Modifying Peer Review Report and Firm Representation Letter Exposure Draft](#) was issued on August 11, 2016. The STF has considered the comments received and incorporated changes as appropriate. Refer to Agenda Item 1.2A for a summary of the comments received on the exposure draft. The full comments can be found [here](#) on the AICPA website.

The goal for the November 2016 PRB meeting is to approve the final proposed Standards and conforming changes.

Final Proposed Standards and Related Conforming Changes (See Agenda Item 1.2B) *Changes to the Proposed Guidance*

After consideration of the comments received, the STF has included the following significant changes or clarifications to that originally proposed in the exposure draft. All changes from the proposals included in the exposure draft are shown in blue font within the materials.

- Paragraphs .209 (Appendix C), .210 (Appendix D), .211 (Appendix E), .213 (Appendix G), .215 (Appendix I), and .217 (Appendix K) [Illustrations of Reports in a System Review and related footnotes]
 - (STF revisions are noted in blue font): “. . . engagements performed under *Government Auditing Standards*, including compliance audits requirements under the Single Audit Act . . .”
- Paragraph .208 8b (Considerations and Illustrations of Firm Representations; Completeness of the Engagement Listing)
 - Consideration: “For System Reviews, where applicable, state that the firm performed the following must-select engagements for the period covered by the peer review and, to the best of their knowledge and belief, at least one of each type of must-select engagement that was performed was selected and reviewed by the peer reviewer:”
 - Illustration: [For system reviews; customized where applicable] We have completed and issued the following must-select engagements and, to the best of our knowledge and belief, the peer review team has selected and reviewed at least one of each category:

The STF is proposing for these changes to be approved effective for reviews commencing January 1, 2017 or later.

Feedback Received

Refer to Agenda Item 1.2A for a summary of the comments received on the exposure draft. The full comments can be found [here](#). Additional feedback was received from GAQC, which has been incorporated into the final proposed guidance.

PRIMA Impact

None expected.

AE Impact

Administering entities (primarily technical reviewers) will evaluate the working papers submitted by team captains to ensure that the peer review reports and firm representation letters reflect the updated and proper wording and request revisions when necessary.

Communications Plan

Staff will develop alerts for reviewers and technical reviewers informing them of the changes to the report and firm representation letter. These alerts would be sent by December 2016. Agenda Item 1.2C includes an introduction and two peer review scenarios that could be included in the alerts. These scenarios provide examples of how to implement the changes to the peer review report and firm representation letter.

Manual Production Cycle (estimated)

The changes to the standards paragraphs will be included in the January 2017 OPL update.

Effective Date

The proposed effective date for these changes is for reviews commencing on or after January 1, 2017.

Board Consideration

- Discuss and approve Agenda Item 1.2B.
- Discuss and approve the introduction and peer review scenarios in Agenda Item 1.2C.
 - Provide feedback on both the introduction and the two scenarios for inclusion in the reviewer and technical reviewer alerts.
 - Discuss whether the report and firm representation letter examples in the scenarios should be included in the PRPM in such places as the PRP 3100 Supplemental Guidance, PRP 4100 Instructions to Firms Having a System Review, and PRP 4200 Instructions to Reviewers Performing System Reviews.

Summary of Comments Received

Respondent	Comments
Burgess Lowman & Lay <ul style="list-style-type: none"> • 3 partner firm • Does not perform audits under GAS 	<ul style="list-style-type: none"> • Do not agree with any of the proposed changes. • Believe that the expanded oversight is sufficient. • Believe that the PRB could address the issues noted via changes to PRP 4100 <i>Instructions to Firms Having a System Review</i>.
Illinois CPA Society	<ul style="list-style-type: none"> • Agreed with the proposed revisions to the peer review report and the firm representation letter.
Cherry Bekaert	<ul style="list-style-type: none"> • Agreed with the proposed revisions to the peer review report. • Disagreed with the proposal to require firms to include a representation regarding the must-select engagements reviewed by the peer reviewer. • Cherry Bekaert believes that reviewed firms are not responsible for the engagements selected and reviewed by a peer reviewer. • Cherry Bekaert proposed changes to the firm representation letter.
NASBA	<ul style="list-style-type: none"> • Agreed with the proposed revisions to the peer review report and the firm representation letter.
North Carolina Association of CPAs	<ul style="list-style-type: none"> • Agreed with the proposed revisions to the peer review report. • Believes that the proposed presentation of the Government Auditing Standards (GAS) and Single Audit must select engagements wording in the firm representation letter suggests that both a GAS audit and a separate Single Audit must be selected for review even if the GAS audit that is reviewed includes a Single Audit.
Washington Society of CPAs	<ul style="list-style-type: none"> • Believes the proposed revisions to the peer review report and the firm representation letter imply that the Single Audit Act includes compliance requirements distinct from those found in the Compliance Supplement. • The Washington Society proposed changes to both the peer review report and the firm representation letter.
Indiana Society of CPAs	<ul style="list-style-type: none"> • Agrees with the proposed revisions to the peer review report and firm representation letter. • Proposed a revision to the firm representation letter for engagement reviews that would require firms to specify that they did not perform audits of employee benefit plans and to specifically

Respondent	Comments
	<p>represent that they did not perform audits under the Single Audit Act.</p> <ul style="list-style-type: none"> Proposed that the report paragraph that discloses must select engagements that were reviewed be presented as a list versus in paragraph form for ease of readability.
The Ohio Society of CPAs	<ul style="list-style-type: none"> Agrees with the proposed revisions to the peer review report and firm representation letter. Proposed a change to firm representation letters for engagement reviews that would require the reviewed firm to represent that if the firm performs “any audit work” prior to the next peer review that the firm will notify the administering entity and then undergo a system review.
Moss Adams	<ul style="list-style-type: none"> Proposed the following changes (identified by red font) to the peer review report and firm representation letter as applicable: “...engagements performed under <i>Government Auditing Standards</i>, including audits of compliance requirements under the Single Audit Act...” “...examinations of service organizations [Service Organizations Control (SOC) 1 and SOC 2 engagements], as applicable...”

Final Proposed Standards

Peer Review Standards

Note: For reasons of simplicity and brevity, the Illustration of Reports in a System Review below only shows the Required Selections and Considerations paragraph containing proposed revisions which is identical in each of the referenced Appendices.

- **Appendix C (Standards Paragraph .209) Illustration of a Report With a Peer Review Rating of *Pass* in a System Review**
- **Appendix D (Standards Paragraph .210) Illustration of a Report With a Peer Review Rating of *Pass (With a Scope Limitation)* in a System Review**
- **Appendix E (Standards Paragraph .211) Illustration of a Report With a Peer Review Rating of *Pass With Deficiencies* in a System Review**
- **Appendix G (Standards Paragraph .213) Illustration of a Report With a Peer Review Rating of *Pass With Deficiencies (With a Scope Limitation)* in a System Review**
- **Appendix I (Standards Paragraph .215) Illustration of a Report With a Peer Review Rating of *Fail* in a System Review**
- **Appendix K (Standards Paragraph .217) Illustration of a Report With a Peer Review Rating of *Fail (With a Scope Limitation)* in a System Review**

Illustrations of Reports in a System Review

Required Selections and Considerations

Engagements selected for review included (engagements performed under *Government Auditing Standards*, including compliance audits requirements under the Single Audit Act, audits of employee benefit plans, audits performed under FDICIA, audits of carrying broker-dealers, and examinations of service organizations [Service Organization Control (SOC) 1 and SOC 2 engagements]).

Appendices C, D, E, G, I, and K related footnotes to the Required Selections and Considerations paragraphs

If the firm performs audits of employee benefit plans, engagements performed under *Government Auditing Standards*, including compliance audits requirements under the Single Audit Act, audits of depository institutions with total assets of \$500 million or greater at the beginning of its fiscal

year, audits of carrying broker-dealers, examinations or service organizations (Service Organization Control (SOC) 1 and SOC 2) or other engagements required to be selected by the board in interpretations 63-1, the engagement type(s) selected for review should be identified in the report using this paragraph, tailored as applicable. If the reviewer selected an engagement under Government Auditing Standards (excluding engagements subject to the Single Audit Act) and also selected an engagement solely to evaluate the a compliance audit requirements under the Single Audit Act, this portion of the sentence should read as follows “Government Auditing Standards, compliance audits requirements under the Single Audit Act,” etc. For SOC engagements, the paragraph should be tailored to reflect the type(s) selected for review. The paragraph should be tailored to indicate if single or multiple engagements were selected for review (for example, an audit versus audits). If the firm does not perform such engagements, this paragraph is not applicable and not included in the report.

Note: For contextual purposes the considerations sections of paragraph .208 of Appendix B are shown in their entirety. In addition, only Illustrations of Firm Representations for system reviews are included. Changes are not being proposed to Firm Representations for Engagement Reviews.

Appendix B

Considerations and Illustrations of Firm Representations

.208

1. The team captain or review captain obtains written representations from management of the reviewed firm to describe matters significant to the peer review in order to assist in the planning and performance of and the reporting on the peer review.
2. The written representations should be obtained for the entire firm and not for each individual engagement the firm performs. Firm management’s refusal to furnish written representations to the team captain or review captain constitutes a failure to cooperate with the peer review program, and the firm would be subject to fair procedures that could result in the firm’s enrollment in the program being terminated (see interpretations). If termination occurs, it may result in an investigation of a possible violation by an appropriate regulatory, monitoring, and enforcement body.
3. On System Reviews, the written representations should be addressed to the team captain (for example, “To John Smith, CPA”). Because the team captain is concerned with events occurring during the peer review period and through the date of his or her peer review report that may require an adjustment to the report or other peer review documents, the representations should be dated the same date as the peer review report.
4. On Engagement Reviews, the representations should be addressed to the review captain (for example, “To John Smith, CPA” or on committee-appointed review team reviews where appropriate, it may be addressed “To the Review Captain”) and dated the same date as the peer review report.

5. The written representations should be signed by individual members of management whom the team captain, review captain or the administering entity believes are responsible for and knowledgeable about, directly or through others in the firm, the matters covered in the representations, the firm, and its system of quality control. Such members of management normally include the managing partner and partner in charge of the firm's system of quality control (this should not be a firm signature).
6. If a representation made by management is contradicted by other information obtained, the team captain or review captain should investigate the circumstances and consider the reliability of the representations made and any effect on the report.
7. The firm is required to make specific representations, as noted in the text that follows. The firm is not prohibited from making additional representations and may tailor the representation letter as it deems appropriate, as long as the minimum applicable representations are made to the team captain or review captain (see interpretations). The team captain or review captain may request additional representations based on the circumstances and nature of the peer review.
8. As of the date of the representation letter and for the peer review year, the firm should do the following:
 - a. Compliance with Rules and Regulations
 - Acknowledge responsibility for complying with the rules and regulations of state boards of accountancy and other regulations
 - Confirm, to the best of its knowledge and belief, that there are no known situations in which the firm or its personnel have not complied with the rules and regulations of state board(s) of accountancy or other regulatory bodies, including applicable firm and individual licensing requirements in each state in which it practices for the year under review.
 - If there are known situations of noncompliance, the confirmation should first summarize the situation(s) where management is aware that the firm or its personnel has not complied with the rules and regulations of state board(s) of accountancy or other regulatory bodies (including applicable firm and individual licensing requirements in each state in which it practices for the year under review) and, if applicable, how the firm has or is addressing and rectifying situations of noncompliance (see interpretations). The confirmation should be written such that other than the summarized situation(s), to the best of its knowledge and belief, there are no known situations in which the firm or its personnel have not complied with the rules and regulations of state board(s) of accountancy or other regulatory bodies, including applicable firm and individual licensing requirements in each state in which it practices for the year under review.
 - b. Completeness of the Engagement Listing
 - State the list of engagements provided to the reviewer:
 - Included all engagements with periods ending (report date for financial forecasts or projections and agreed upon procedures) during the year under review, regardless of whether issued
 - Included, but was not limited to, all engagements performed under *Government Auditing Standards*, including compliance

audits requirements under the Single Audit Act, audits of employee benefit plans, audits performed under FDICIA, audits of carrying broker-dealers, examinations of service organizations [Service Organizations Control (SOC) 1 and SOC 2 engagements], as applicable

- For System Reviews, where applicable, state that the firm performed the following must-select engagements for the period covered by the peer review and, to the best of their knowledge and belief, at least one of each type of must-select engagement that was performed was selected and reviewed by the peer reviewer: engagements performed under Government Auditing Standards, including compliance audits requirements under the Single Audit Act, audits of employee benefit plans, audits performed under FDICIA, audits of carrying broker-dealers, examinations of service organizations [Service Organizations Control (SOC) 1 and SOC 2 engagements]. If the reviewer selected an engagement under Government Auditing Standards (excluding engagements subject to the Single Audit Act) and also selected an engagement solely to evaluate the compliance audit under the Single Audit Act, the list of engagements should read as follows: “Engagements performed under Government Auditing Standards; compliance audit(s) under the Single Audit Act...”
 - For Engagement Reviews, state that the firm does not perform engagements under the Statements on Auditing Standards (SASs) or *Government Auditing Standards*, examinations under the Statements on Standards for Attestation Engagements (SSAEs), or engagements under the Public Company Accounting Oversight Board (PCAOB) Standards that are not subject to PCAOB permanent inspection
 - Acknowledge that failure to properly include these engagements on the list could be deemed as failure to cooperate and may result in termination from the Peer Review Program and, if termination occurs, may result in an investigation of a possible violation by the appropriate regulatory, monitoring, and enforcement body
- c. Firm Remediation of Nonconforming Engagements, if applicable
- Confirm it will remediate nonconforming engagements as stated by the firm on the Matter For Further Consideration Form, Finding for Further Consideration Form, or Letter of Response, as applicable.
- d. Communications From Regulatory, Monitoring, or Enforcement Bodies
- State that the firm has discussed significant issues from reports and communications (see interpretations) from regulatory, monitoring and enforcement bodies (see interpretations), with the team captain or review captain, if applicable.
 - State that the firm has provided the team captain or review captain with any other information requested, including communications or summaries of communications from regulatory, monitoring, or enforcement bodies relating to allegations or investigations of deficiencies in the conduct of an accounting, audit, or attestation engagement performed and reported on by the firm, whether the matter relates to the firm or its personnel, within three years preceding the current peer review year-end.
 - Confirm, to the best of its knowledge and belief, that there are no known restrictions or limitations on the firm’s or its personnel’s ability to practice public accounting by

regulatory, monitoring, or enforcement bodies within three years preceding the current peer review year-end OR

- Include a summary of the restrictions or limitations on the firm's or its personnel's ability to practice public accounting by regulatory, monitoring, or enforcement bodies within three years preceding the current peer review year-end.

e. Quality Control Materials

- State that it understands the intended uses and limitations of the quality control materials it has developed or adopted.
- For System Reviews, state that it has tailored and augmented the materials as appropriate such that the quality control materials encompass guidance which is sufficient to assist it in conforming with professional standards (including the Statements on Quality Control Standards) applicable to its accounting and auditing practice.
- For Engagement Reviews, state it has tailored and augmented the materials as appropriate such that the quality control materials encompass guidance which is sufficient to assist it in conforming with professional standards (including the Statements on Quality Control Standards) applicable to its accounting practice.

f. Other Representations

- Include other representations requested by the team captain or review captain based on the circumstances and nature of the peer review.

Illustration of a Representation Letter That Has No Significant Matters to Report to the Team Captain for a System Review

(The firm may tailor the language in this illustration and refer to attachments to the letter as long as adequate representations pertaining to the matters previously discussed, as applicable, are included to the satisfaction of the team captain.)

October 31, 20XX

To the [Name of Team Captain]:

We are providing this letter in connection with the peer review of [name of firm] as of the date of this letter and for the year ended June 30, 20XX.

We understand that we are responsible for complying with the rules and regulations of state boards of accountancy and other regulators. We confirm, to the best of our knowledge and belief, that there are no known situations in which [name of firm] or its personnel have not complied with the rules and regulations of state board(s) of accountancy or other regulatory bodies, including applicable firm and individual licensing requirements in each state in which it practices for the year under review.

We have provided a list of all engagements to the team captain with periods ending (report date for financial forecasts or projections and agreed upon procedures) during the year under review, regardless of whether issued as of this the date of this letter. This list appropriately identified and

included, but was not limited to, all engagements performed under *Government Auditing Standards*, including compliance audits requirements under the Single Audit Act, audits of employee benefit plans, audits performed under FDICIA, audits of carrying broker-dealers, and examinations of service organizations (~~Service Organizations Control (SOC)~~ 1 and SOC 2 engagements), as applicable. We understand that failure to properly include ~~these~~ engagements ~~on the list subject to the scope of the peer review~~ could be deemed as failure to cooperate. We also understand this may result in termination from the Peer Review Program and, if termination occurs, may result in an investigation of a possible violation by the appropriate regulatory, monitoring, and enforcement body.

[For system reviews; customized where applicable] We have completed and issued the following must-select engagements and, to the best of our knowledge and belief, the peer review team has selected and reviewed at least one of each category:

1. Engagements performed under *Government Auditing Standards*
2. Compliance Audits of compliance requirements under the Single Audit Act
3. Audits of employee benefit plans
4. Audits performed under FDICIA
5. Audits of carrying broker-dealers
6. Examinations of service organizations [Service Organizations Control (SOC) 1 and SOC 2 engagements]

We have discussed significant issues from reports and communications from regulatory, monitoring and enforcement bodies with the team captain, if applicable. We have also provided the team captain with any other information requested, including communications or summaries of communications from regulatory, monitoring, or enforcement bodies relating to allegations or investigations of deficiencies in the conduct of an accounting, audit, or attestation engagement performed and reported on by the firm, whether the matter relates to the firm or its personnel, within three years preceding the current peer review year-end. We confirm, to the best of our knowledge and belief, that there are no known restrictions or limitations on the firm's or its personnel's ability to practice public accounting by regulatory, monitoring, or enforcement bodies within three years preceding the current peer review year-end.

We understand the intended uses and limitations of the quality control materials we have developed or adopted. We have tailored and augmented the materials as appropriate such that the quality control materials encompass guidance that is sufficient to assist us in conforming with professional standards (including the Statements on Quality Control Standards) applicable to our accounting and auditing practice in all material respects.

Sincerely,

[Signature]

Illustration of a Representation Letter That Has Been Tailored for Significant Matters to Report to the Team Captain for a System Review

(The firm may tailor the language in this illustration and refer to attachments to the letter as long as adequate representations pertaining to the matters previously discussed, as applicable, are included to the satisfaction of the team captain.)

October 31, 20XX

To [Name of Team Captain]:

We are providing this letter in connection with the peer review of [name of firm] as of the date of this letter and for the year ended June 30, 20XX.

We understand that we are responsible for complying with the rules and regulations of state boards of accountancy and other regulators. Other than the firm not having a practice unit license during the year under review in one state where the firm practices (which has been subsequently obtained), we confirm, to the best of our knowledge and belief, that there are no known situations in which [name of firm] or its personnel have not complied with the rules and regulations of state board(s) of accountancy or other regulatory bodies, including applicable firm and individual licensing requirements in each state in which it practices for the year under review.

We have provided a list of all engagements to the team captain with periods ending (report date for financial forecasts or projections and agreed upon procedures) during the year under review, regardless of whether issued as of the date of this letter. This list appropriately identified and included, but was not limited to, all engagements performed under *Government Auditing Standards*, including compliance audits requirements under the Single Audit Act, audits of employee benefit plans, audits performed under FDICIA, audits of carrying broker-dealers, and examinations of service organizations (~~{Service Organizations Control~~ {SOC} 1 and SOC 2 engagements~~}),~~ as applicable. We understand that failure to properly include ~~these~~ engagements ordinarily subject to the scope of the peer review on the list could be deemed as failure to cooperate. We also understand this may result in termination from the Peer Review Program and, if termination occurs, may result in an investigation of a possible violation by the appropriate regulatory, monitoring, and enforcement body.

[For system reviews; where applicable] We have completed and issued the following must-select engagements and, to the best of our knowledge and belief, the peer review team has selected and reviewed at least one of each category:

1. Engagements performed under *Government Auditing Standards*
2. ~~Compliance Audits of compliance requirements under the Single Audit Act~~
3. Audits of employee benefit plans
4. Audits performed under FDICIA
5. Audits of carrying broker-dealers
6. Examinations of service organizations [~~Service Organizations Control (SOC) 1 and SOC 2 engagements~~]

We confirm that we will implement the remedial plans for nonconforming engagements stated in our response to Finding for Further Consideration Forms 1 and 3.

We have discussed significant issues from reports and communications from regulatory, monitoring and enforcement bodies with the team captain, if applicable. We have also provided the team captain with any other information requested, including communications or summaries of communications from regulatory, monitoring, or enforcement bodies relating to allegations or investigations of deficiencies in the conduct of an accounting, audit, or attestation engagement performed and reported on by the firm, whether the matter relates to the firm or its personnel, within three years preceding the current peer review year-end. Other than the single partner restriction to perform employee benefit plans as determined by the AICPA Professional Ethics Division, we confirm, that to the best of our knowledge and belief, there are no known restrictions or limitations on the firm's or its personnel's ability to practice public accounting within three years preceding the current peer review year-end.

We understand the intended uses and limitations of the quality control materials we have developed or adopted. We have tailored and augmented the materials as appropriate such that the quality control materials encompass guidance that is sufficient to assist us in conforming with professional standards (including the Statements on Quality Control Standards) applicable to our accounting and auditing practice in all material respects.

Sincerely,

**Reviewer Alert – Examples of Peer Review Reports and Firm Representation Letters
Under new Guidance (Agenda Item 1.2B)**

Final changes to the Standards were approved by the Peer Review Board during their November 14, 2016 Open Session (refer to Agenda Item 1.2). The changes are effective for peer reviews commencing on or after January 1, 2017. Key changes to the guidance pertain to the peer review report and firm representation letter wording used when firms perform audits in accordance with *Government Auditing Standards* (GAS) including compliance audits under the Single Audit Act.

The scenarios presented below are intended to provide illustrations of firm representation letters and peer review reports under the new guidance and consider the following situations:

1. Firms that perform audits subject to both GAS and the Single Audit Act.
2. Firms that perform audits subject to GAS only, in addition to audits subject to both GAS and the Single Audit Act.

Scenario 1 (engagements subject to both GAS and the Single Audit Act)

The firm of Smith & Jones, LLP performs an audit of a not-for-profit entity that is subject to *Government Auditing Standards* and the Single Audit Act. This firm also audited an employee benefit plan. The financial statements of both the not-for-profit entity and the employee benefit plan fall into the firm's peer review year and both audit engagements were selected and reviewed by the firm's peer reviewer (Bobbie Kelly, CPA). The peer review year end was June 30, 2016 and the exit conference was conducted on October 31, 2016. The peer review report rating was pass. The firm's administering entity is the North Carolina Association of CPAs.

Firm Representation Letter (no significant matters to report to the team captain)

October 31, 2016

To Bobbie Kelly, CPA:

We are providing this letter in connection with the peer review of Smith & Jones, LLP as of the date of this letter and for the year ended June 30, 2016.

We understand that we are responsible for complying with the rules and regulations of state boards of accountancy and other regulators. We confirm, to the best of our knowledge and belief, that there are no known situations in which Smith & Jones, LLP or its personnel have not complied with the rules and regulations of state board(s) of accountancy or other regulatory bodies, including applicable firm and individual licensing requirements in each state in which it practices for the year under review.

We have provided a list of all engagements to the team captain with periods ending (report date for financial forecasts or projections and agreed upon procedures) during the year under review, regardless of whether issued as of the date of this letter. This list appropriately identified and

included, but was not limited to, all engagements performed under *Government Auditing Standards*, including compliance audits under the Single Audit Act, audits of employee benefit plans, audits performed under FDICIA, audits of carrying broker-dealers, and examinations of service organizations [Service Organization Control (SOC) 1 and SOC 2 engagements], as applicable. We understand that failure to properly include engagements subject to the scope of the peer review could be deemed as failure to cooperate. We also understand this may result in termination from the Peer Review Program and, if termination occurs, may result in an investigation of a possible violation by the appropriate regulatory, monitoring, and enforcement body.

We have completed and issued the following must-select engagements and, to the best of our knowledge and belief, the peer review team has selected and reviewed at least one of each category:

1. Engagements performed under *Government Auditing Standards*, including compliance audits under the Single Audit Act
2. Audits of employee benefit plans

We have discussed significant issues from reports and communications from regulatory, monitoring and enforcement bodies with the team captain, if applicable. We have also provided the team captain with any other information requested, including communications or summaries of communications from regulatory, monitoring, or enforcement bodies relating to allegations or investigations of deficiencies in the conduct of an accounting, audit, or attestation engagement performed and reported on by the firm, whether the matter relates to the firm or its personnel, within three years preceding the current peer review year-end. We confirm, to the best of our knowledge and belief, that there are no known restrictions or limitations on the firm's or its personnel's ability to practice public accounting by regulatory, monitoring, or enforcement bodies within three years preceding the current peer review year-end.

We understand the intended uses and limitations of the quality control materials we have developed or adopted. We have tailored and augmented the materials as appropriate such that the quality control materials encompass guidance that is sufficient to assist us in conforming with professional standards (including the Statements on Quality Control Standards) applicable to our accounting and auditing practice in all material respects.

Sincerely,

William T. Jones, CPA
Managing Partner

System Peer Review Report

October 31, 2016

To the Partners of Smith & Jones, LLP and the Peer Review Committee of the North Carolina Institute of CPAs.

We have reviewed the system of quality control for the accounting and auditing practice of Smith & Jones, LLP (the firm) in effect for the year ended June 30, 2016. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants (Standards).

A summary of the nature, objectives, scope, limitations of, and the procedures performed in a System Review as described in the Standards may be found at www.aicpa.org/prsummary. The summary also includes an explanation of how engagements identified as not performed or reported in conformity with applicable professional standards, if any, are evaluated by a peer reviewer to determine a peer review rating.

Firm's Responsibility

The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. The firm is also responsible for evaluating actions to promptly remediate engagements deemed as not performed or reported in conformity with professional standards, when appropriate, and for remediating weaknesses in its system of quality control, if any.

Peer Reviewer's Responsibility

Our responsibility is to express an opinion on the design of the system of quality control and the firm's compliance therewith based on our review.

Required Selections and Considerations

Engagements selected for review included an engagement performed under *Government Auditing Standards*, including a compliance audit under the Single Audit Act, and an audit of an employee benefit plan.

As a part of our peer review, we considered reviews by regulatory entities as communicated by the firm, if applicable, in determining the nature and extent of our procedures.

Opinion

In our opinion, the system of quality control for the accounting and auditing practice of Smith & Jones, LLP in effect for the year ended June 30, 2016, has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)* or *fail*. XYZ & Co. has received a peer review rating of *pass*.

Bobbye Kelly & Associates

Scenario 2

The firm of Smith & Jones, LLP performs an audit of a local government that is performed in accordance with Government Auditing Standards. The local government does not expend Federal funds. The firm also audited an employee benefit plan and a not-for-profit entity that is subject to Government Auditing Standards and the Single Audit Act. The financial statements of the local government, the employee benefit plan, and the not-for-profit entity fell into the firm's peer review year. After consulting Interpretation 63-1, the peer reviewer (Bobbye Kelly, CPA) selected the local government and the employee benefit plan and also decided to review only the Single Audit portion of the audit of the not-for-profit entity. The peer review year end was June 30, 2016 and the exit conference was conducted on October 31, 2016. The peer review report rating was pass. The firm's administering entity is the North Carolina Association of CPAs.

Firm Representation Letter (no significant matters to report to the team captain)

October 31, 2016

To Bobbye Kelly, CPA:

We are providing this letter in connection with the peer review of Smith & Jones, LLP as of the date of this letter and for the year ended June 30, 2016.

We understand that we are responsible for complying with the rules and regulations of state boards of accountancy and other regulators. We confirm, to the best of our knowledge and belief, that there are no known situations in which Smith & Jones, LLP or its personnel have not complied with the rules and regulations of state board(s) of accountancy or other regulatory bodies, including applicable firm and individual licensing requirements in each state in which it practices for the year under review.

We have provided a list of all engagements to the team captain with periods ending (report date for financial forecasts or projections and agreed upon procedures) during the year under review, regardless of whether issued as of the date of this letter. This list appropriately identified and included, but was not limited to, all engagements performed under *Government Auditing Standards*, including compliance audits under the Single Audit Act, audits of employee benefit plans, audits performed under FDICIA, audits of carrying broker-dealers, and examinations of service organizations [Service Organization Control (SOC) 1 and SOC 2 engagements], as applicable. We understand that failure to properly include engagements subject to the scope of the peer review could be deemed as failure to cooperate. We also understand this may result in termination from the Peer Review Program and, if termination occurs, may result in an investigation of a possible violation by the appropriate regulatory, monitoring, and enforcement body.

We have completed and issued the following must-select engagements and, to the best of our knowledge and belief, the peer review team has selected and reviewed at least one of each category:

1. Engagements performed under *Government Auditing Standards*

2. Compliance audits under the Single Audit Act
3. Audits of employee benefit plans

We have discussed significant issues from reports and communications from regulatory, monitoring and enforcement bodies with the team captain, if applicable. We have also provided the team captain with any other information requested, including communications or summaries of communications from regulatory, monitoring, or enforcement bodies relating to allegations or investigations of deficiencies in the conduct of an accounting, audit, or attestation engagement performed and reported on by the firm, whether the matter relates to the firm or its personnel, within three years preceding the current peer review year-end. We confirm, to the best of our knowledge and belief, that there are no known restrictions or limitations on the firm's or its personnel's ability to practice public accounting by regulatory, monitoring, or enforcement bodies within three years preceding the current peer review year-end.

We understand the intended uses and limitations of the quality control materials we have developed or adopted. We have tailored and augmented the materials as appropriate such that the quality control materials encompass guidance that is sufficient to assist us in conforming with professional standards (including the Statements on Quality Control Standards) applicable to our accounting and auditing practice in all material respects.

Sincerely,

William T. Jones, CPA
Managing Partner

System Peer Review Report

October 31, 2016

To the Partners of Smith & Jones, LLP and the Peer Review Committee of the North Carolina Institute of CPAs.

We have reviewed the system of quality control for the accounting and auditing practice of Smith & Jones, LLP (the firm) in effect for the year ended June 30, 2016. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants (Standards).

A summary of the nature, objectives, scope, limitations of, and the procedures performed in a System Review as described in the Standards may be found at www.aicpa.org/prsummary. The summary also includes an explanation of how engagements identified as not performed or reported in conformity with applicable professional standards, if any, are evaluated by a peer reviewer to determine a peer review rating.

Firm's Responsibility

The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. The firm is also responsible for evaluating actions to promptly remediate engagements deemed as not performed or reported in conformity with professional standards, when appropriate, and for remediating weaknesses in its system of quality control, if any.

Peer Reviewer's Responsibility

Our responsibility is to express an opinion on the design of the system of quality control and the firm's compliance therewith based on our review.

Required Selections and Considerations

Engagements selected for review included an engagement performed under *Government Auditing Standards*, a compliance audit under the Single Audit Act, and an audit of an employee benefit plan.

As a part of our peer review, we considered reviews by regulatory entities as communicated by the firm, if applicable, in determining the nature and extent of our procedures.

Opinion

In our opinion, the system of quality control for the accounting and auditing practice of Smith & Jones, LLP in effect for the year ended June 30, 2016, has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)* or *fail*. XYZ & Co. has received a peer review rating of *pass*.

Bobbye Kelly & Associates

Revised Form for CPA Firms Aligned with Non-CPA Owned Entities

Why is this on the Agenda?

Background

During the May 2015 Peer Review Board (PRB) meeting, the PRB approved new checklists for evaluating a firm's system of quality control. At that time, the PRB directed staff to develop checklists to replace those at PRP Sections 5100, 5200 and 5300 for firms aligned with non-CPA owned entities.

Subsequently, AICPA Staff studied the data in PRISM and discovered that, out of ~15,000 firms that underwent a system review in the last 3 years, **only 51 firms indicated on the background form that they are aligned with a non-CPA owned entity**. Based on the comments provided by each firm explaining their relationship, it appears the majority may have misunderstood the question (for example, many referred to the sale of non-attest portions of their practice to non-CPA owned entities, or the fact that one of their partners was not a CPA).

Based on this data, at their August 2016 meeting, the Standards Task Force (STF) directed Staff to develop a more concise form to replace Sections 5100, 5200 and 5300.

The new 4-page form (reduced from 32 pages) was approved by the STF at their October 2016 meeting. The form, which appears at Agenda Item 1.3A,

- Incorporates the concepts covered in the current instructions to PRP Sections 5100, 5200 and 5300 while providing new examples and guidance to increase clarity;
- Refers reviewers to the new Design and Compliance QC checklists to assist them in evaluating design and testing for compliance; and
- Requires reviewers to document
 - Non-compliance with QC Section 10 on the Design checklist, and
 - Non-compliance with the firm's QCPP on the Compliance checklist.

Please note that the proposed form only contains questions related to Relevant Ethical Requirements, Human Resources, and Monitoring as reviewers would address all other elements of the quality control standards in the new Guidelines for Review of Quality Control Policies and Procedures and Guidelines for Testing Compliance with Quality Control Policies and Procedures checklists approved at the May PRB meeting.

Feedback Received

The revised form was designed to address feedback from the STF. The STF noted that the form should succinctly address

- The relationship between the non-CPA owned entity and the firm;
- The effect of this relationship on the CPA firm's system of quality control;
- The design of the non-CPA owned entity's relevant policies and procedures; and
- The non-CPA owned entity's compliance with their policies and procedures.

PRISM Impact

None

AE Impact

None

Communications Plan

Staff will raise awareness about the new form upon approval by the PRB.

Manual Production Cycle (estimated)

January 2017

Effective Date

January 2017

Board Consideration

1. Consider and approve the new form at Agenda Item 1.3A.

PRP Section **TBD**

Supplemental Guidelines for Review of Quality Control Policies and Procedures for Non-CPA Owned Entities Closely Aligned With a CPA Firm

- .01** This section of the manual contains a supplemental questionnaire that the reviewer should complete when a CPA firm is closely aligned with a non-CPA owned entity through common employment; leasing of employees, equipment or facilities; or other similar arrangements. In these situations, the CPA firm sells all or a portion of its non-attest practice to a non-CPA owned entity. However, the majority of the financial interests in the CPA firm's attest practice is owned by CPAs. (Also see the "Alternative Practice Structures" interpretation (AICPA, *Professional Standards*, ET sec. 1.220.020) for further information regarding the effect of alternative practice structures on CPA firms.)
- .02** A CPA firm's system of quality control must encompass all six quality control elements described in Statement on Quality Control Standards (SQCS) No. 8, *A Firm's System of Quality Control (Redrafted)* (AICPA, *Professional Standards*, QC sec. 10), (effective as of January 1, 2012). However, when a CPA firm is closely aligned with a non-CPA owned entity, certain portions of the CPA firm's system of quality control may reside at or operate in conjunction with the non-CPA owned entity's system of control.
- .03** For example, the non-CPA owned entity may implement policies and procedures which:
- Make its personnel aware of the relationships that may impair independence and obtain written confirmations of compliance with independence policies and procedures;
 - Require its personnel performing audits, reviews, compilations or other attest engagements to attend relevant continued professional education; or
 - Periodically evaluate the performance of the owners of the CPA firm.
- .04** These policies and procedures must be considered as part of the peer review and generally relate to the following quality control elements: (1) relevant ethical requirements (including independence, integrity and objectivity), (2) human resources, and/or (3) monitoring of the elements noted in (1) and (2).
- .05** When evaluating the design of the CPA firm's quality control policies and procedures (QCPP) during the planning phase of the review, the reviewer must identify relevant policies and procedures at the non-CPA owned entity and use his or her professional judgment to determine whether they were designed to comply with QC section 10. Any instances of non-compliance with QC section 10 should be reflected as "no" answers in PRP Section 4600, *Guidelines for Review of Quality Control Policies and Procedures for Firms with Two or More Personnel*.
- .06** Before testing a CPA firm's compliance with their QCPP, the reviewer will develop a plan for the nature and extent of compliance testing, including testing of compliance with relevant policies and procedures at the non-CPA owned entity. The plan will be documented in the *Summary Review Memorandum* and the number and type of tests will be based upon the reviewer's assessment of peer review risk. Compliance testing should include interviews of:
- Personnel of the non-CPA owned entity who devote at least 25 percent of their time to performing audits, reviews, compilations, preparation or other attest engagements, or who have partner/manager level responsibility for the overall supervision and review of those engagements; and
 - Personnel of the non-CPA owned entity who are not directly involved in the performance of audits, reviews, compilations, preparation or other attest engagements, in order to determine whether they are fa-

miliar with the non-CPA owned entity's policies and procedures related to relevant ethical requirements (including independence, integrity, and objectivity), human resources, and the monitoring of those quality control elements.

.07 Any instances of non-compliance with the firm's QCPP should be documented in PRP Section 4650, *Guidelines for Testing Compliance with Quality Control Policies and Procedures for Firms with Two or More Personnel*.

AICPA Peer Review Program

SUPPLEMENTAL GUIDELINES FOR REVIEW OF QUALITY CONTROL POLICIES AND PROCEDURES FOR NON-CPA OWNED ENTITIES CLOSELY ALIGNED WITH A CPA FIRM

Firm	Prepared By	Date

Ques.	Description
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1. Describe the arrangement between the CPA firm and the non-CPA owned entity.

2. For each of the following quality control elements, describe the portions of the CPA firm's system of quality control which reside at or operate in conjunction with the non-CPA owned entity's system of control:

Relevant Ethical Requirements

Human Resources

Monitoring

- 3. Review the relevant ethical requirements, human resources and monitoring sections of PRP Section 4600. Evaluate the design of relevant policies and procedures at the non-CPA owned entity and document that evaluation below. Reflect any non-compliance with QC Section 10 as a “no” answer on PRP Section 4600.

- 4. Review the relevant ethical requirements, human resources and monitoring sections of PRP Section 4650. Test compliance with relevant policies and procedures at the non-CPA owned entity, documenting the nature of the tests and the results below. Reflect any non-compliance with the non-CPA owned entity’s policies and procedures as a “no” answer on PRP Section 4650.



Peer Review Program