

Reviewer alert

September 2018 – REVISED October 23, 2018

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New Guidance on the Evaluation of Non-compliance with the Risk Assessment Standards and its Peer Review Impact

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

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

The guidance:

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

Reviewer Evaluation of Engagements

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

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

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

Insufficient risk assessment

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

Failure to link procedures performed to the risk assessment

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

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

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

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

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

Peer Review Impact

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

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

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

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

Required Firm Remediation

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

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

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

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

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

Other Important Information

PRIMA

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

Reviewer Performance

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

Resources for Risk Assessment

Free webcast with CPE:

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

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

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

Note to Attendees of 2018 Peer Review Conference

During the Peer Review Update presentation, substantial attention was given to Exhibit CX-7.1 (Risk Assessment Summary Form) used in the methodology developed by Practitioners' Publishing Company (PPC). From some participant comments, a misperception may exist that this is the only form required to be completed with this methodology to evidence compliance with the risk assessment standards. In fact, PPC's methodology includes several exhibits/forms to use for this purpose. Also, as noted above, evidence of compliance may be achieved by means other than completing forms from practice aids.

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2018 Yellow Book Released!

On July 17, 2018, the U.S. Government Accountability Office (GAO) released its highly anticipated revision of *Government Auditing Standards*, also referred to as GAGAS or the Yellow Book.

Summary of Changes

The 2018 revision incorporated extensive input and feedback from members of the Yellow Book Advisory Council, as well as feedback received during the public comment period on the 2017 exposure draft. Independence and the following requirements for auditors who perform nonaudit services for an audited entity are of particular interest to auditors and peer reviewers.

- **Auditors should conclude that preparing financial statements in their entirety from a client-provided trial balance or underlying accounting records creates significant threats to auditors' independence and should document the threats and safeguards applied to eliminate and reduce threats to an acceptable level or decline to provide the services (par. 3.88)**
- **Certain other bookkeeping and financial statement preparation activities (e.g., preparing certain line items or sections of the financial statements based on information in the trial balance, posting entries that the audited entity's management has approved to the entity's trial balance) create threats to independence that an auditor should evaluate to determine whether they are significant, and document the evaluation of the significance of such threats (par. 3.89)**

The end of Chapter 3 of the 2018 Yellow Book contains two flowcharts to further illustrate independence requirements and enhance auditor understanding.

Other key changes include, but are not limited to:

- Revised format that differentiates requirements from application guidance
- Added application guidance related to obtaining CPE specifically on Yellow Book, particularly during years in which there are revisions to the standards
- Modified the peer review section to identify recognized peer review organizations (including AICPA); require that audit organizations comply with their respective affiliated organization's peer review requirements and certain other requirements; and provides additional requirements for audit organizations not affiliated with recognized peer review organizations.
- Provided new guidance to address waste and abuse as defined in the Yellow Book
- Provides new standards for reviews of financial statements performed under *Government Auditing Standards*
- Updated the performance audit standards with specific considerations for when internal control is significant to the audit objectives

Effective Date

The new standards are effective for financial audits, attestation engagements and reviews of financial statements for periods ending on or after June 30, 2020, and for performance audits beginning on or after July 1, 2019. Early implementation is not permitted.

2018 Yellow Book Resources

Please refer to [GAO's Yellow Book Web page](#) for an electronic version of the 2018 Yellow Book and to learn more about the new standard. Additionally, a GAQC Web event titled, [2018 Yellow Book: What You Need to Know](#), will be held on Tuesday September 25, 2018, from 1:00 - 3:00pm (ET) related to this topic.

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New Functionality Added to PRIMA

In August, functionality was added to:

- Perform nightly automated checks that identify potential ineligible peer reviewers
- Enable peer reviewers to view their reviewer performance dashboard³ which includes:
 - feedback issued (reviewer performance feedback forms, monitoring letters, performance deficiency letters)
 - individual corrective actions,
 - restrictions, including potential ineligibility reasons, and
 - hearings

In early September, functionality was added to:

- Issue performance deficiency letters
- Acknowledge/sign performance deficiency letters
- Suspend peer reviewers for not acknowledging the performance deficiency letter
- Appeal performance deficiency letters
- Check for consistencies within the Peer Review Information (PRI) form⁴
- Check for consistencies between the PRI form and the Review Summary form⁵ (for both system and engagement reviews)

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Effective Date of Data Hosting Services Interpretation Delayed

The Professional Ethics Executive Committee decided delay the effective date of the new [Hosting Services](#) interpretation (ET 1.295.143) until July 1, 2019, so members can implement necessary changes. The interpretation was originally scheduled to become effective on September 1, 2018.

Questions related to the interpretation may be directed to ethics@aicpa.org or 888.777.7077. Implementation resources will be ready at the end of the year on the [ethics website](#).

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³ The dashboard can be accessed from the PRIMA home page and clicking on For Peer Reviewers and then Reviewer Performance Dashboard.

⁴ Checks for consistency with the PRI form include checks that require a firm to change an answer before the form can be submitted and checks that strongly suggest a firm to change an answer.

⁵ Checks for consistency between the PRI form and the Review Summary form require types of engagements and must-select engagements to be consistent between the PRI and the review information before the peer review team's working papers can be submitted to the AE and may result in the captain requesting the firm to update its PRI.

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Save the Date for 2018 RAB Member Training

Mark your calendars for the 2018 RAB Member training to be held on November 15, 2018 from 2:00 – 4:00 pm ET. Click [here](#) to register. Please note: the CPA on staff (or individual managing the Program) for each administering entity must register prior to submitting the annual Plan of Administration (POA).

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