October 2020

PRP Section 3100

Supplemental Guidance

Notice to Readers

Supplemental Guidance (SG) of the AICPA Standards for Performing and Reporting on Peer Reviews are developed in open meetings by the AICPA Peer Review Board for peer reviews of firms enrolled in the AICPA Peer Review Program. Supplemental Guidance need not be exposed for comment and are not the subject of public hearings. This guidance is applicable to firms (and individuals) enrolled in the program; individuals and firms who perform and report on peer reviews; entities approved to administer the peer reviews; associations of CPA firms, whose members are also AICPA members, authorized by the board to assist its members in forming review teams; and the AICPA program staff. The guidance is effective upon issuance unless otherwise indicated.

Review Requirements for Joint Ventures

Joint ventures formed specifically to perform certain engagements are not required to have a peer review provided that

- each of the firms that sign the joint venture report is required to have system reviews and agree to list the joint venture(s) on their client rosters during their peer reviews.

- the joint venture is not operating and structured as a separate firm. (Joint ventures do not include part time work arrangements, when only one firm issues the report.) If the letterhead used for the joint venture does not identify the separate firms that joined together to perform the engagement, then the joint venture is operating as a separate firm.

Surprise Engagements

The following are several examples for selecting surprise engagements.

Question 1:

Sole practitioner #1 only has one “must select” audit engagement (Employee Retirement Income Security Act [ERISA]), one very small manufacturing audit, and 15 review engagements, the team captain’s risk assessment may determine that selecting the ERISA covers the audit level of service. There would be no need to select the manufacturing

audit, and the peer reviewer would select one or more reviews. Sole practitioner #2 has two ERISA audits, several audits of manufacturers, and 15 review engagements.

Answer 1:

a. In the case of sole practitioner #1, the ERISA audit cannot be a surprise as it is a "must select," and, assuming that the risk assessment concluded that the other audit would not be selected, a review engagement would be the surprise. The team captain's conclusion should be adequately documented in the SRM (including that the appropriate "audit level" coverage results with the "must select" audit), and it is appropriate to select the surprise engagement from the next highest level of service.

b. In the case of sole practitioner #2, it is likely that the risk assessment would identify that only one ERISA, at least one manufacturing audit, and one or more reviews would be selected. So if two audits were going to be selected by the reviewer and there is a population large enough for it to be a surprise, then that is the level of service the surprise engagement should come from. The reviewer could select one of the two ERISA audits or one of the manufacturing audits to be the surprise. Of course whether a surprise engagement or not, an ERISA audit must be selected. Once again the team captain's conclusion should be adequately documented in the SRM.

c. Another situation that is more difficult to apply is when on sole practitioner #1's peer review, the peer reviewer's risk assessment determines that it would be appropriate to look at several key audit areas of the firm's manufacturing audit (maybe it wasn't a very small audit) in addition to the ERISA audit. It would be acceptable for the manufacturing audit, even though only the key audit areas are being reviewed, to satisfy the surprise engagement requirement.

The board recognizes that it is not always possible for the reviewer to know whether a reviewed firm expects a certain engagement to be selected. In this case, the reviewed firm may or may not have expected the manufacturing audit to be selected. Reviewers are asked to use their professional judgment in these situations.

Question 2:

A firm only performs one audit, one AUP engagement and/or one review engagement and/or one compilation engagement.

Answer 2:

Although it is possible when assessing and documenting a risk assessment that if a firm performs one of each of these engagements that they may not all be selected for the peer review but realistically all of them being selected would not be a surprise to the firm.

Therefore, for example, where the firm performs only one of each of these, a team captain would not be prohibited from notifying the firm when presenting the original list of engagements to be selected that he or she may select an engagement that wasn't on the original list. This is not required because it really does not constitute a surprise engagement, but it is permitted.

Question 3:

Will there be a surprise audit engagement selected when a two partner firm performs two manufacturing audits of a similar size (one by each partner) and no other engagements?

Answer 3:

A reviewed firm would realistically expect both audits to be selected, and, therefore, picking both would not be a surprise. However, similar to the answer in question 2, a team captain would not be prohibited from notifying the firm that one audit is selected when presenting the original list of selected engagements and that he or she may select the engagement that wasn't on the original list.

Question 4:

Can there ever be a surprise engagement when a sole practitioner (with professional staff) only performs two audits (independent of any other level of service performed)?

Answer 4:

A team captain's risk assessment would indicate to pick both audits (maybe one is an initial client and the other a high risk industry) and reasons why in some cases only one of the 2 audits would need to be selected (existing clients in same industry). It is possible that in either case a reviewed firm would realistically expect both audits to be selected, and, therefore, picking both would not be a surprise to them. Therefore, the team captain must use professional judgment in determining whether there would be a "surprise engagement" in these instances. If a risk assessment indicates that only one audit should be selected, a team captain may inform the firm he or she will select at least one audit upon arrival (without saying which one). If a risk assessment indicates that both audits should be selected, the team captain would not be prohibited from notifying the firm that one audit is selected when presenting the original list of engagements and that he or she may select the other audit upon arrival.

The team captain should thoroughly document his or her considerations in the SRM, and a Report Acceptance Body (RAB) should not be expected to challenge the team captain in the two-audit scenario unless it is somehow very apparent that there should have been a surprise audit selected.

Question 5:

When the firm does not have an audit that is eligible to select as the surprise engagement, what level of service should be selected?

Answer 5:

When the threshold for selecting an audit is not met (as discussed in the previous questions and answers [Q&As]), similar logic should be applied to selecting an engagement performed under the Statements on Standards for Attestation Engagements (SSAEs) and then Statements on Standards for Accounting and Review Services (SSARS) as the surprise engagement.

The team captain should thoroughly document his or her considerations in the SRM, and a RAB should not be expected to challenge the team captain unless it is very apparent that there should have been a surprise engagement selected or one of a different level of service than what was selected.

Peer Reviewers or Firms That Consider Withdrawing From a Peer Review After the Commencement of Fieldwork

The responsibilities of peer reviewers are detailed in the AICPA Standards for Performing and Reporting on Peer Reviews (Standards) and Interpretations, as are those of the reviewed firm, including when a firm may resign from the AICPA PRP. However, very rarely do circumstances develop whereby a reviewer determines that he or she must withdraw from the peer review. Although rare, the reasons may vary and may include poor health, not receiving the required documents from the reviewed firm within a reasonable time frame (or other lack of cooperation matters), personality conflicts with the reviewed firm that cannot be overcome, not meeting the requirements to be a peer reviewer after the fieldwork on a peer review has commenced, and other reasons.

The preceding list is not intended to be all-inclusive nor indicate when it is appropriate for a peer reviewer to withdraw from a peer review. However, such matters should be discussed with the entity administering the peer review. Some ramifications of withdrawing lead to matters that will need to be resolved solely between the peer reviewer and the firm, whereas other matters (also based on the validity and types of reasons) might also result in firm noncooperation or reviewer performance issues that will need to be addressed simultaneously by the administering entity as well. The peer reviewer needs to be aware that this could affect his or her ability to perform future reviews, and the firm needs to be aware that this could affect its ability to meet licensing and other regulatory requirements, as well as AICPA membership requirements, if applicable.

Also, there are very rare circumstances when a reviewed firm considers withdrawing from its peer review after fieldwork has begun. The reasons vary here as well and may include poor health, not receiving timely correspondences from the peer reviewer, and personality conflicts with the reviewer that cannot be overcome and other reasons. This

list is not intended to be all-inclusive or indicate when it is appropriate for a reviewed firm to withdraw from a peer review. However, such matters should be discussed with the entity administering the peer review. Some ramifications of withdrawing lead to matters that will need to be resolved solely between the peer reviewer and the firm, whereas other matters (also based on the validity and types of reasons) might also relate to firm noncooperation or reviewer performance that will need to be addressed simultaneously by the administering entity as well. The firm should be made aware of the difference between resigning from the AICPA PRP, which is specifically addressed in the Standards and Interpretations, versus possibly withdrawing from an existing review and immediately hiring a new reviewer to perform another peer review by its due date. The firm also needs to be aware that this could affect its ability to meet licensing and other regulatory requirements, as well as AICPA membership requirements, if applicable.

Consulting Between the Reviewed Firm and the Peer Reviewer

Understandably, a peer reviewer can be a valuable source of information to the reviewed firm outside of the peer review process. The Interpretations discuss other relationships or situations that would impair independence and those that wouldn't. However, professional judgment must be used in many cases when during the period between peer reviews, the reviewed firm "consults" with the firm it intends to use as its reviewer. Consulting with the reviewing firm does not impair that firm's ability to perform a subsequent peer review. However, when the frequency and extent of that consultation becomes an integral part of the reviewed firm's system of quality control (on any type of peer review), independence would then be considered impaired.

What is meant by an integral part of the firm's system of quality control? Although professional judgment must be considered, independence would be considered impaired when the frequency and extent of the consultation becomes necessary and essential for the firm's system of quality control, as a whole, to remain designed and in compliance with professional standards in all material respects. There are many factors to consider such as, but not limited to, the size of the firm in terms of number of partners, engagements, and industries.

- For example, if a sole practitioner who previously only had one omit disclosure compilation engagement has been asked to perform an ERISA audit and asks the potential peer reviewer to come in for a day and assist the firm in establishing and maintaining a system of quality control and teach the firm how to perform an ERISA audit, professional judgment would suggest that the reviewer's independence for peer review purposes has been impaired in this instance.

- Had the reviewed firm, in the preceding example, only called the potential peer reviewer to ask if using a specific audit guide, quality control standards and other materials currently in the reviewed firm's library (or other peer reviewed materials that can be added to the library) would be appropriate and if the

reviewer had any recommendations on a course or conference that might also be helpful to take prior to performing the audit, independence would not be impaired.

Planning and Performing Compliance Tests of Requirements of Voluntary Membership Organizations

Only those membership requirements which are specifically imbedded into the firm's written system of quality control and directly contribute to the firm's compliance with SQCS are within the scope of peer review, not because they are a membership requirement, but rather because they are an integral part of the firm's system of quality control for the firm to comply with SQCS. As an example, take a firm who is a member of the Employee Benefit Plan Audit Quality Center (EBPAQC), and thus is subject to its membership requirement for certain employee benefit plan-specific continuing professional education (CPE) be taken within a certain timeframe for certain individuals. The membership requirements further require that the CPE requirement be included in the firm's quality control documents. Assume the peer reviewer on the firm's System Review noted a deficiency in ERISA engagements, and he or she suspected based on discussions with the firm's personnel that they were not up-to-date on ERISA developments and that their not taking ERISA related CPE gave rise to the deficiency. If the peer reviewer believed, based on his or her risk assessment of the situation, that testing of the ERISA based CPE would enhance the conclusions, then they should be tested. If the testing confirmed that the appropriate ERISA related CPE was not taken as required by the firm's system of quality control, the cause of the deficiency would be noncompliance with the firm's system of quality control (and not noncompliance with the firm's EBPAQC membership requirements).

Impact on Peer Review Results and Reporting

Management Representation Letters

The standards discuss the documentation on an engagement that should be reviewed in a system review or an engagement review.

Professional standards require a written representation letter from management for all financial statements and periods covered by the accountant's report. The representations should be made no earlier than the date of the accountant's review report.

For purposes of peer review, if a management representation letter is dated differently than the report date, the incorrect dating alone would not cause an engagement to be not in compliance with professional standards. It may be considered a matter, depending on how materially different the dates are, and the pervasiveness should be considered when determining whether the matter should be elevated to a finding in a System Review. On an Engagement Review, if the dating is not materially different, it would not be required to be included in a finding, if it is materially different, it would be a finding. The reviewer should use his or her judgment in determining whether the dating is materially different.

If the management representation letter does not meet substantially all of the other requirements or the firm failed to obtain a management representation letter, the engagement should be deemed as not in compliance with professional standards.

Impact on the Peer Review When Firm or Individual(s) Do Not Possess Licenses

Firm Licenses: For System and Engagement Reviews, when a reviewer identifies that a firm does not possess the required applicable license(s) to issue accounting and auditing engagements, for any period of time covered by the peer review year, a Finding for Further Consideration (FFC) must indicate this fact.

Further, the administering entity's peer review committee (committee) must require an implementation plan that the firm submits a valid license(s) to the committee. If the reviewed firm obtains a valid license(s) prior to the committee requesting the implementation plan, they should immediately submit the license to the committee. In this situation, the committee will be able to consider the review without the need to request an implementation plan because the reviewed firm will have already obtained a valid license(s). The firm's license number should not be identified on the peer review documents and the information obtained should not be reported directly to the state board because it was obtained as a part of the peer review.

Firms in states with retroactive license provisions must apply the preceding rules even though the firm has the opportunity to obtain a valid license.

Individual License(s): For System and Engagement Reviews, engagements should be classified as not complying with professional standards if the partners or other employees with reporting responsibilities do not have a current individual license to practice public accounting as required by the state board(s) of accountancy.

- System Reviews: The presence of an engagement not complying with professional standards does not automatically result in a *pass with deficiency* or *fail* report. Reviewers must consider the nature, causes, pattern, pervasiveness, and relative importance to the system of quality control, including the lack of an individual license, in determining the systemic failure in the firm's system of quality control.

- Engagement Reviews: If a reviewer reviews an engagement that was issued when the individual did not possess the required license to practice, it is a deficiency. If deficiencies are not evident on all of the engagements submitted for review, a *pass with deficiency* report should be issued. However, when the reviewer otherwise concludes that deficiencies are evident on all of the engagements submitted for review, a *fail* report is issued.

Engagement Reviews — Considerations When There Are Several Departures From GAAP That Are Immaterial

In reviewing generally accepted accounting principles (GAAP) basis financials with no report modification, a reviewer performing an engagement review may find several departures from GAAP, such as amortization of goodwill, marketable securities presented at cost, and a small amount of Section 179 depreciation (immediate write off) of fixed assets. It is possible that each of these items is individually or together collectively immaterial on one engagement, and at the same time obvious departures from GAAP. While discussing the "No Answers" and matters documented on the Matter for Further Consideration (MFC) form(s), it may become evident that the firm is not aware of the departures, but it claims it is immaterial anyway. Would the matter(s) rise to the level of a finding, deficiency, or significant deficiency?

If an individual finding is immaterial, if findings are collectively immaterial, or both, based on the current objectives of an engagement review (including whether the engagements submitted for review conform with the requirements of professional standards *in all material respects*), the threshold of a "deficiency" is not to be included in a peer review report with a rating of *pass with deficiency* or *fail*. However, a reviewer needs to use professional judgment in determining whether collectively the "in all material respects" threshold has not been met.

In addition paragraph .110b of the Standards section "Identifying Matters, Findings, Deficiencies and Significant Deficiencies" states that a finding should be issued in connection with an Engagement Review when the review captain concludes that "financial statements or information, the related accountant's reports submitted for review, or the procedures performed, including related documentation, were not performed or reported on in conformity with the requirements of applicable professional standards." The definition of a finding does not discuss materiality or relative importance.

Thus, although the objective of an Engagement Review, and the report, discuss "in all material respects," the definition of a finding leaves room for immaterial departures to be included in a finding. Professional judgment should be used when making this determination, and whereas in this example it might not be inappropriate to elevate the matter(s) to a finding due to the number of matters noted on one engagement, a different conclusion may be reached if three engagements were reviewed and each one had a single immaterial departure that ordinarily would not be included in the finding.

Implications of Performing Nonattest Services

The AICPA Peer Review Board (board) has determined that when a firm performs an engagement when it lacks independence, the engagement would be deemed as not being performed or reported on in conformity with applicable professional standards in all material respects (except on compilation engagements where the accountant's report has appropriately noted the lack of independence).

However, if a firm fails to meet the documentation requirements of "Documentation Requirements When Providing Nonattest Services" interpretation, [fn 1] under the "Independence Rule" (ET sec. 1.200.001), that alone does not cause an impairment of independence and therefore does not automatically result in the engagement being deemed as not performed or reported on in conformity with applicable professional standards in all material respects, provided the firm did establish the understanding with the attest client called for in paragraph .01*c* of the "General Requirements for Performing Nonattest Services" interpretation (ET sec. 1.295.040).

The "Documentation Requirements When Providing Nonattest Services" interpretation (ET sec. 1.295.050) does not apply to nonattest services performed prior to the client becoming an attest client. However, upon the acceptance of an attest engagement, the member should prepare written documentation demonstrating his or her compliance with the other general requirements during the period covered by the financial statements, including the requirement to establish an understanding with the client.

When a firm fails to meet any of the other requirements of the interpretations of the "Nonattest Services" subtopic (ET sec. 1.295), independence has been impaired and the engagement would be deemed as not being performed or reported on in conformity with applicable professional standards in all material respects.

The board has considered the impact of the interpretations of the "Nonattest Services" subtopic on each type of peer review. The following guidance details three specific areas for reviewers to consider:

- What procedures should peer reviewers perform to determine if firms are performing nonattest services and if the firm is in compliance with the requirements of the "Nonattest Services" subtopic where applicable?

- What documentation should peer reviewers be discussing with the firm or physically be reviewing?

- How should peer reviewers treat the firm's failure to comply with the "Nonattest Services" subtopic?

System Reviews

Review teams should first evaluate the firm's policies and procedures and compliance therewith for identifying all services performed for all clients. The peer review quality control policies and procedures questionnaires completed by the reviewed firm request

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[fn 1] All ET sections can be found in AICPA *Professional Standards*.

the firm to identify whether the firm performs nonattest services. (The firm's own quality control documents may contain this information as well.) In addition, the peer review engagement checklist profile information completed by the reviewed firm on all engagements selected for review asks the firm if it performs nonattest services for the client. The questionnaires and profile information also serve as representations made by the reviewed firm for the review team to follow when completing the team captain and engagement checklists.

Review teams should then determine whether the firm has complied with the requirements of the "Nonattest Services" subtopic, including the firm's documentation of the understanding with the client. Review teams should consider the pattern and pervasiveness of any "Nonattest Services" subtopic matters and their implications for compliance with the firm's system of quality control as a whole, in addition to their nature, causes, and relative importance in the specific circumstances in which they were observed, to determine their effects on the peer review results.

Engagement Reviews

Reviewers (and the firms they review) should be aware that the "Nonattest Services" subtopic, including its documentation requirements, is applicable to engagements performed under the SSAEs as well as SSARS, including compilations. (Although the requirements related to nonattest services are contained in the "Nonattest Services" subtopic. Engagement Reviews include the review of all documentation required by the SSARS and the SSAEs, which encompass the AICPA Code of Professional Conduct.

There are very few situations where a firm undergoing an engagement review would *not* be subject to either documentation requirements required by the SSAES, SSARS, or the interpretations of the "Nonattest Services" subtopic:

1. The firm does not perform any nonattest services for its attest clients (including compilation clients).

2. The firm only performs compilations, and the reports have appropriately disclosed the lack of independence.

Therefore, reviewers should review the firm's documentation of the understanding with the client to determine if the firm is in compliance with the "Documentation Requirements When Providing Nonattest Services" interpretation. For compilation engagements performed under SSARS, the review captain may request to review all documentation if the firm has represented that the documentation is appropriate but the review captain has cause to believe that the documentation may not have been prepared in accordance with applicable professional standards.

Review teams should first evaluate the engagement checklist profile information completed by the reviewed firm on all engagements submitted for review. This document

asks the firm if it performs nonattest services for the client along with specific questions regarding documentation required by the "Documentation Requirements When Providing Nonattest Services" interpretation. The profile information also serves as representations made by the reviewed firm for the reviewer to follow when completing the review captain's summary and the engagement checklists. The profile information also provides common examples of nonattest services to assist the reviewed firm.

The firm's failure to comply with the "Documentation Requirements When Providing Nonattest Services" interpretation alone would not result in an engagement being deemed as not having been performed or reported on in conformity with applicable professional standards in all material respects, or result in the issuance of a *pass with deficiency* or *fail* report. Instead, it would be considered a finding. The review captain should consider the guidance for findings, deficiencies, and significant deficiencies in an Engagement Review to determine the further classification of the circumstances and the effect on the peer review results.

Further Information

Additional guidance on nonattest services is available at https://www.aicpa.org/content/dam/aicpa/interestareas/professionalethics/resources/tools/downloadabledocuments/nonattestservicesfaqs.pdf. Alternatively, please call the AICPA Ethics Hotline at 888.777.7077 (menu option 5, followed by option 2), or contact the ethics division by email at ethics@aicpa.org.

Reviewers should also be aware of other documentation that may be required by professional standards such as that found in paragraph .09 of the "Conceptual Framework for Independence" under the "Independence Rule" in which members must document the threats and safeguards applied when threats to independence are not at an acceptable level.

Peer Review Guidance for SAS No. 115, *Communicating Internal Control Related Matters Identified in an Audit*

SAS No. 115, *Communicating Internal Control Related Matters Identified in an Audit* (AU-C sec. 265) [fn 2] defines the terms *deficiency in internal control*, *significant deficiency*, and *material weakness*; provides guidance on evaluating the severity of deficiencies in internal control identified in an audit of financial statements; and requires the auditor to communicate, in writing, to management and those charged with governance, significant deficiencies and material weaknesses identified in the audit. In addition, SAS No. 115 heightens the auditor's awareness that his or her clients are ultimately responsible for their system of internal control and financial statements and,

[fn 2] All AU-C sections can be found in AICPA *Professional Standards*.

therefore, must weigh and manage the associated risks. SAS No. 115 is effective for all financial statement audits for periods ending on or after December 15, 2009, however, early implementation is permitted. For audits that have period end dates prior to December 15, 2009, the peer reviewer will need to determine whether the firm's engagement team was applying SAS No. 112 or SAS No. 115.

In performing the peer review, reviewers should be alert for audit documentation that could indicate a significant deficiency or material weakness was present but not identified by the engagement team. Such audit documentation might include material adjusting journal entries or indications that the engagement team participated in the preparation of an estimate or in the drafting of the financial statements or notes.

Auditors are not required to perform procedures to identify deficiencies in internal control or to express an opinion on the effectiveness of the entity's internal control. SAS No. 115 permits the auditor to issue a communication that no material weaknesses were identified during the audit, but, the auditor should not issue a written communication stating that no significant deficiencies were identified during the audit.

SAS No. 115 has two requirements:

- The auditor should evaluate the severity of each deficiency in internal control to determine whether the deficiency, individually or in combination, is a significant deficiency or material weaknesses.

- The auditor should communicate, in writing, significant deficiencies and material weaknesses to management and those charged with governance as part of each audit. This communication includes significant deficiencies and material weaknesses identified and communicated to management and those charged with governance in previous audits, and have not yet been remediated.

SAS No. 115 defines a *deficiency in internal control*, *significant deficiencies*, and *material weaknesses* in the following manner:

Deficiency in internal control. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis.

Significant deficiency. A significant deficiency is a deficiency, or combination of deficiencies, that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Material weakness. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement

of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Additional Guidance for SAS No. 115 Related to Internal Controls Over Compliance

The Office of Management and Budget (OMB) issued a statement clarifying that these terms are to be used as defined in the generally accepted auditing standards issued by the AICPA and *Government Auditing Standards* issued by the Government Accountability Office. Therefore, the following definitions should be used when an auditor reports on internal control over compliance in a single audit. This interpretation does not modify or replace an auditor's responsibility for communicating internal control over financial reporting matters under SAS No. 115 or reporting such matters as required by *Government Auditing Standards* issued by the U.S. Government Accountability Office.

Deficiency in Internal Control Over Compliance — A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct noncompliance with a type of compliance requirement of a federal program on a timely basis.

Significant Deficiency in Internal Control Over Compliance — A significant deficiency in internal control over compliance is a deficiency, or combination of deficiencies in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Material Weakness in Internal Control Over Compliance — A material weakness in internal control over compliance is a deficiency, or combination of deficiencies in internal control over compliance, such that there is a reasonable possibility that a material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected on a timely basis.

Additionally, the U.S. Department of Housing and Urban Development Office of the Inspector General likewise defines the preceding deficiency terms used in the *Consolidated Audit Guide for Audits of HUD Programs (HUD Guide)*. However, the *HUD Guide* specifically changes the language "noncompliance with a type of compliance requirement of a federal program" to reflect "noncompliance with applicable requirements of a HUD-assisted program."

Note: The preceding definitions of a *deficiency* and *significant deficiency* are different than the definitions or criteria used in determining *deficiencies* and *significant deficiencies* in peer review.

The following chart will assist peer reviewers in evaluating the various situations that may be encountered during a peer review of audits where SAS No. 115 is applicable.

For simplicity, the terms as they relate to Internal Control Over Compliance will be used synonymously with the terms Deficiency, Material Weakness, and Significant Deficiency in Internal Control in the following chart, unless otherwise noted.

Situation	SAS 115 Guidance	Peer Review Guidance
Auditor did not have specific procedures in place to identify deficiencies in internal control.	The auditor is not required to perform procedures to identify deficiencies in internal control. ***Note:*** The auditor is required to obtain an understanding of internal control sufficient to plan the audit by performing procedures to understand the design of controls relevant to an audit of financial statements and determining whether they have been placed in operation.	**No MFC** — performing procedures to identify deficiencies in internal control is not a requirement of SAS No. 115. However, if the auditor has failed to obtain an understanding of internal control sufficient to plan the audit, a MFC related to that matter would be warranted.
Audit documentation indicates that the client likely had a control deficiency; however, the auditor failed to identify the control deficiency or failed to evaluate the severity of the control deficiency.	The auditor should evaluate the severity of each deficiency in internal control to determine whether the deficiency individually or in combination, is a significant deficiency or material weakness.	**No MFC** if the control deficiencies do not rise to the level of significant deficiency or material weakness. **MFC** if the auditor failed to identify a control deficiency that is evident from the audit documentation. For example, the audit documentation might indicate that the auditor identified material misstatements and made proposing journal entries to the client. Those proposed journal entries are indicators of a control deficiency

Situation	SAS 115 Guidance	Peer Review Guidance
		that should have been evaluated by the auditor. ***Note:*** See following guidance in evaluating if the engagement was not performed or reported on in conformity with applicable professional standards.
Auditor identified deficiencies in internal control and determined that those deficiencies, individually or in combination, represent a significant deficiency or material weakness.	The requirements of SAS No. 115 are met providing the auditor communicates the identified deficiency or weakness in writing to management and those charged with governance no later than 60 days following the report release date.	**No MFC** if a written, timely communication [fn 3] was made to management and those charged with governance. **MFC** if the auditor fails to communicate the deficiency or weakness in writing to management and those charged with governance no later than 60

[fn 3] The written communication should

- state that the purpose of the audit was to express an opinion on the financial statements, but not to express an opinion on the effectiveness of the entity's internal control over financial reporting.
- state that the auditor is not expressing an opinion on the effectiveness of internal control.
- include the definition of the terms significant deficiency and, where relevant, material weakness.
- identify the matters that are considered to be significant deficiencies and, if applicable, those that are considered to be material weaknesses.
- state that the communication is intended solely for the information and use of management, those charged with governance, and others within the organization, and that it is not intended to be and should not be used by anyone other than these specified parties. If an entity is required to furnish such auditor communications to a governmental authority, specific reference to such governmental authorities may be made.

Situation	SAS 115 Guidance	Peer Review Guidance
		days following the report release date. **FFC/REPORT**: The peer reviewer should determine the relative importance of the matter(s) noted during the peer review to the firm's system of quality control as a whole and their nature, causes, pattern and pervasiveness, to determine if they rise to the level of a finding, deficiency or significant deficiency as described in the standards and how they should be reported. The peer reviewer should use judgment in evaluating the significance of the failure to communicate and, generally, the peer reviewer should respect the auditor's professional judgment. Although the evaluation of a firm's system of quality control is the primary objective of a System Review and the basis for the peer review report, if the failure to communicate included audits conducted under GAS (the Yellow Book), or the Single Audit Act, or included clients with operating audit committees, the engagement could be deemed to be not performed or reported on in conformity with applicable professional standards. In circumstances where an engagement is not conducted under the Yellow Book or there is no operating audit committee, generally the engagement would not be deemed as not performed

Situation	SAS 115 Guidance	Peer Review Guidance
		or reported on in conformity with applicable professional standards if this was the only deficiency noted.
Auditor identified deficiencies in internal control and did not evaluate whether they were a significant deficiency or a material weakness.	SAS No. 115 requires the auditor to evaluate the severity of each deficiency in internal control identified during the audit to determine whether the deficiency, individually or in combination, is a significant deficiency or a material weakness.	**MFC** because the auditor identified the deficiencies in internal control but did not evaluate whether they were a significant deficiency or material weakness. ***Note:*** See preceding guidance in evaluating if the engagement was not performed or reported on in conformity with applicable professional standards.
Auditor identified deficiencies in internal control and upon evaluation, determined that they were not a significant deficiency or material weakness. The deficiencies in internal control were not communicated to management or those charged with governance.	SAS No. 115 requires the auditor to evaluate the severity of each deficiency in internal control identified during the audit to determine whether the deficiency, individually or in combination, are significant deficiencies or a material weakness. If deficiencies in internal control are evaluated and determined not to be a significant deficiency or material weakness, SAS No. 115 does not require the deficiencies in internal control to be communicated with management or those charged with governance.	**No MFC** because SAS No. 115 requires the auditor to evaluate the severity of each deficiency in internal control identified during the audit to determine whether the deficiency, individually or in combination, are significant deficiencies or a material weakness. Because the deficiencies in internal control were evaluated and determined not to be a significant deficiency or a material weakness, they are not required to be communicated to management or those charged with governance.
Auditor identified deficiencies in internal control and upon	For example, audit documentation	This should be handled as a disagreement in the same manner

Situation	SAS 115 Guidance	Peer Review Guidance
evaluation, determined that they were not a significant deficiency or material weakness. During the peer review, the team captain determines that the identified deficiencies in internal control are likely to be a significant deficiency or a material weakness which should have been communicated in writing.	indicates that the auditor identified a material adjustment relative to income taxes. The proposed adjustment was provided to the firm and recorded. The firm represents that no material weakness exists; yet upon inquiry of firm personnel and review of audit documentation, the peer reviewer determines that the client does not have controls capable of preventing, or detecting and correcting possible misstatements to the income tax accrual.	as other disagreements between reviewer and firm. The team captain, and if possible the reviewed firm, should contact the AICPA technical hotline or AICPA Audit and Attest staff for additional guidance. The team captain may also need to consult with the technical reviewer and committee chair.
During an audit procedure, the auditor determined a deficiency in internal control was a significant deficiency or material weakness. The auditor orally communicated the identified deficiency as soon as it was identified to management and those charged with governance.	SAS No. 115 allows the auditor the ability to orally communicate identified deficiencies or weakness provided that the auditor issues a written communication no later than 60 days following the report release date.	**No MFC** if a written, timely communication [fn 4] was made to management and those charged with governance. **MFC** if the auditor failed to communicate the deficiency or weakness in writing to management and those charged with governance no later than 60 days following the report release date. ***Note:*** See preceding guidance in evaluating if the engagement was not performed or reported on in

[fn 4] See footnote 3.

Situation	SAS 115 Guidance	Peer Review Guidance
		conformity with applicable professional standards.
The auditor develops journal entries for fixed asset depreciation and recommends client's posting to its general ledger. However, the audit documentation indicates that the client has effective controls in place over fixed assets and that such controls have been placed in operation.	Nothing in SAS No. 115 precludes the auditor from performing this or other nonattest services. ***Note:*** The peer reviewer should be aware of the independence requirements of the *Code of Professional Conduct (including 101-3)* and *Government Auditing Standards.* If the peer reviewer determines that this service constitutes a nonattest service, the peer reviewer should assess the impact of such services on independence of the auditor in light of the general activity against "Establishing or maintaining internal controls, including performing ongoing monitoring activities for a client."	**No MFC** if the audit documentation indicates that the client had effective controls in place over fixed assets and the auditor determined that those controls had been placed in operation.
Auditor prepares FASB 109 disclosure and provides necessary journal entries for posting by client. Client has a level of understanding such that the auditor meets AICPA ethics	Because the client does not have controls in place that would prevent or detect and correct a misstatement, the auditor has	**No MFC** if the auditor evaluates the deficiency in internal control and determines that a significant deficiency or material weakness exists and a written, timely communication [fn 5] was made to

[fn 5] See footnote 3.

Situation	SAS 115 Guidance	Peer Review Guidance
independence requirements, but the auditor determines the client does not have the ability to independently prepare the correct entries. Therefore the auditor has determined that a deficiency in internal control exists.	appropriately detected a deficiency in internal control. The severity of the deficiency in internal control must be evaluated to determine if it was a significant deficiency or a material weakness.	management and those charged with governance no later than 60 days following the report release date. **No MFC** if the auditor evaluates the deficiency in internal control and determines that a significant deficiency or material weakness does not exist and the peer reviewer agrees with that assessment. **MFC** if the auditor (1) did not determine whether the deficiency was significant or constituted a material weakness or (2) determined the deficiency was significant or constituted a material weakness and failed to provide written communication to management and to those charged with governance no later than 60 days following the report release date or (3) the peer reviewer believes that a significant deficiency or material weakness existed and the firm determined that one did not. ***Note:*** See preceding guidance in evaluating if the engagement was not performed or reported on in conformity with applicable professional standards.
During interim fieldwork and before the client's year-end date, the auditor identifies a	For some matters, early communication to management or those	**No MFC** because the written communication [fn 6] was provided

[fn 6] See footnote 3.

Situation	SAS 115 Guidance	Peer Review Guidance
deficiency in internal control and determines it is a material weakness. The auditor provides a written communication in a letter to management and those charged with governance.	charged with governance may be important because of their relative significance and the urgency for corrective follow-up action. SAS No. 115 does not distinguish how the written communication is to be done. It does specify that it must be provided no later than 60 days following the report release date, even if such significant deficiencies or material weaknesses were remediated during the audit.	no later than 60 days following the report release date.
The auditor does not identify any deficiencies in internal control during the audit. The auditor provides written communication to the client indicating that significant deficiencies were not identified during the audit.	SAS No. 115 indicates that the auditor should not issue a written communication stating that no significant deficiencies were identified during the audit because of the potential for misinterpretation of the limited degree of assurance provided by such a communication. ***Note:*** A client may ask the auditor to issue a communication indicating that no material weaknesses were identified during the audit of the financial statements for the client to submit to	**MFC** should be issued if the auditor provided written communications that no significant deficiencies were identified. **FFC/REPORT**: The peer reviewer should determine the relative importance of the matter(s) noted during the peer review to the firm's system of quality control as a whole and their nature, causes, pattern and pervasiveness, to determine if they rise to the level of a finding, deficiency, or significant deficiency as described in the standards and how they should be reported. The peer reviewer should use judgment in evaluating the significance of the failure to communicate, and,

Situation	SAS 115 Guidance	Peer Review Guidance
	governmental authorities. Also note that it would not be appropriate for an auditor to issue a communication at an interim date that no significant deficiencies or no material weaknesses were identified.	generally, the peer reviewer should respect the auditor's professional judgment.
Auditor drafts the financial statements, including footnote disclosures. However, the auditor determines the client does not have controls in place to prevent or detect and correct material misstatements in their financial statements.	The severity of the deficiency in internal control must be evaluated to determine if it is a significant deficiency or a material weakness. ***Note:*** Generally, no deficiency in internal control would exist where the client possesses or acquires, from a source other than the audit firm, a level of understanding necessary to prepare the financial statements and related footnotes and reviews the financial statements and related footnotes in sufficient detail to assume responsibility and prevent and detect misstatements.	**No MFC** if the auditor evaluates the deficiency in internal control and determines that a significant deficiency or material weakness exists and a written, timely communication [fn 7] was made to management and those charged with governance. **No MFC** if the auditor evaluates the deficiency in internal control and determines that a significant deficiency or material weakness does not exist and thus no communication was made to management or those charged with governance. **MFC** if the auditor failed to provide written communication to management and to those charged with governance no later than 60 days following the report release date. ***Note:*** See preceding guidance in evaluating if the engagement was not performed or reported on in

[fn 7] See footnote 3.

Situation	SAS 115 Guidance	Peer Review Guidance
		conformity with applicable professional standards.

Repeat Findings, Deficiencies, and Significant Deficiencies

The following are examples of identifying repeat findings, deficiencies and significant deficiencies.

System Review

A firm's system of quality control requires that all audit procedures are reviewed by a manager or above. In the prior review the underlying cause of a finding related to analytical procedures was a lack of review and supervision by a manager or above. As a result, the auditors placed a high level of assurance on an analytic that indicated a significant unexpected difference and that difference was not investigated. Although not significant enough to warrant a deficiency in the report, the lack of review by a manager or above was the underlying cause included on a related FFC form. During the current peer review, significant differences identified in reconciliation testing were not investigated. Again, the underlying cause was determined to be the lack of review and supervision by a manager or above. Even though the working paper areas in which findings were identified are different, because the underlying cause to both is the lack of an appropriate level of review and supervision, this would be considered a repeat finding in the current review.

In the prior peer review the underlying cause of disclosure deficiencies was that although Partner A performed pre-issuance reviews on all engagements before releasing them, the reviews were not performed comprehensively enough in scope to avoid significant disclosure deficiencies. Although not required by professional standards, the partner did not use an engagement reporting and disclosure checklist, nor did the firm's system of quality control require its use, nor did the firm's system employ any other method that would ensure that the partner review would be performed comprehensively on all engagements. The use of this checklist could have contributed to a comprehensive review assuming all of the relative procedures to each engagement were performed. This was clearly a design deficiency. Though the current peer review identifies significant disclosure deficiencies, upon investigation the review team finds that the firm's system of quality control requires the use of the reporting and disclosure checklist. Partner B is responsible for performing the pre-issuance reviews, and the review team finds out that Partner B is not performing it on all engagements. This is a compliance deficiency and as such would not be deemed a repeat even though it led to significant disclosure deficiencies (as in the prior peer review).

In the prior review, there was a finding that the firm's system of quality control did not require appropriate supervisory review of compiled monthly financial statements. As a

result, required disclosures were omitted from the financial statements. Compilations comprise a significant portion of the firm's audit and accounting practice. The firm revised its quality control policies and procedures to require a supervisory review. In the current peer review, the firm did not perform the supervisory review of compiled monthly financial statements. The lack of supervisory review resulted in inconsistent report and financial statement titling, referencing both income tax and cash basis which resulted in a deficiency in the report. The team captain determined that the revised quality control policies requirement of a supervisory review was not communicated to firm staff, audit programs were not modified to incorporate supervisory review, and the peer reviewer determined that the firm did not effectively implement the revised quality control policies and procedures for supervisory review. As such, it was determined that this is a repeat design deficiency in relation to supervisory review because the firm has not appropriately designed and implemented proper policies and procedures.

Engagement Review

In the prior review, the firm received a FFC due to the misclassification of a repayment of a principal amount due on a loan as an investing activity instead of a financing activity on the statement of cash flows. During the current review the firm received a FFC due to failure to disclose a noncash transaction of purchasing equipment directly through seller financing. The current year finding would not be considered a repeat finding. To be considered a repeat finding in an Engagement Review, the finding must be substantially the same as noted in the prior review.

In both the current and prior peer reviews, the firm did not obtain a client management representation letter for the review engagements selected. As such, this would be considered a repeat deficiency in the current peer review report.

Reviewed Firm Name Changes

A reviewed firm may change its name during the peer review year or after the peer review year-end but prior to the peer review report being presented for acceptance to the peer review committee. A firm should complete the Notification of Change in Firm Structure Form whenever there is merger, dissolution, or just a name change and should submit this information to the administering entity and discuss any questions it may have with the administering entity. The AICPA will make a determination whether for peer review purposes it will be treated as solely a name change. The peer reviewer is issuing a report on a period covering one year and should include the name that appeared on the letterhead of the reports issued by the firm during that year.

If subsequent to the peer review year-end the firm changed its name, the new name may appear as well. Ideally these matters should be dealt with such that the report and, if applicable, response thereto presented to the peer review committee reflect these revisions. For example, ABC firm had a peer review for the year ended 9/30/07 and changed its name to ABCDE firm effective 11/1/07. The peer review took place on

12/1/07, and the peer review report was issued 12/15/07. In this example the report could be addressed to (and all references in the report could refer to "ABCDE firm (formerly known as ABC firm"). However, at a minimum, the report should contain a reference to ABC firm because that was the name on the letterhead of the reports issued by the firm during the peer review year.

If the firm underwent a name change in the middle of the peer review year, the report should be addressed to the firm's most current name and could also indicate in the body of the report, "also doing business as." So in the previous example, assume ABC firm changed its name to ABCDE firm on 3/31/07. The peer review report would appropriately be addressed to ABCDE firm but the body of the report could refer to ABCDE firm "also doing business as ABC firm" during the peer review year. Reports were issued on both letterheads for the reports issued by the firm.

A firm would have a name change in the following situations:

- A partner is leaving the firm and taking no accounting or auditing (A&A) clients from this firm to a new firm.
- A partner is joining the firm and bringing no A&A clients into the firm.
- A staff member has been promoted to partner.
- A firm name is changed for commercial purposes (PLLC, LLC, PC).

If the firm's name changed due to a merger, or acquisition, dissolution, or sale, this guidance may not be applicable.

Responding to Engagements Not Performed or Reported on in Conformity With Applicable Professional Standards in all Material Respects (Nonconforming)

Interpretation No. 67-1 indicates that the reviewed firm (firm) should make appropriate considerations to address engagements that are identified during the peer review that are not performed or reported on in conformity with applicable professional standards in all material respects (nonconforming). The primary responsibility is on the firm to follow professional standards to address these types of engagements. Auditing and accounting standards provide guidance for firms when this information comes to the attention of the firm subsequent to the report release date, such as information identified as a result of a peer review. The relevant professional standards include

- AU-C section 560, *Subsequent Events and Subsequently Discovered Facts*

- SSARS No. 19, *Framework for Performing and Reporting on Compilation and Review Engagements* or SSARS No. 21, *Statements on Standards for Accounting and Review Services: Clarification and Recodification* [fn 8], as applicable

- AU-C section 585, *Consideration of Omitted Procedures After the Report Release Date*.

- "Breach of Independence" interpretation (ET sec. 1.298.010)

Interpretation No. 67-1 indicates that the reviewer should remind the firm of its responsibilities to follow the relevant professional standards to address these situations.

The firm should make and document comprehensive assessments about whether it is necessary to perform omitted procedures, or whether a material reporting error necessitates reissuance of an accounting or auditing report, revision to the financial statements, or remediation of the subsequent engagement. The firm should thoroughly consider the continued reliance by third party users on reports issued and procedures performed. Particularly, the firm should consider the expectations of regulatory bodies that the firm will perform the omitted procedures or correct reports in a timely manner.

The firm is expected to follow applicable professional standards regarding documentation of the omitted procedures, if performed, document performance or reissuance considerations, and provide a response to the peer reviewer. The firm's initial assessment should be timely and generally take place during the peer review to enable the peer reviewer to reach a proper conclusion about the engagement and evaluate the firm's response to the situation. If the firm does not have time to determine the appropriate remediation prior to the exit conference, the firm may indicate interim steps taken while it explores the best approach. The firm's response should be documented on the MFC form that appropriately describes the most significant matters indicating the engagement is nonconforming

The peer reviewer should evaluate the firm's actions planned or taken or its reasons for concluding that no action is required for nonconforming engagement. The peer reviewer should thoroughly document these situations in the Summary Review Memorandum for System Reviews and Review Captain's Summary for Engagement Reviews, including whether they believe the firm's considerations support its decision and whether a monitoring action is suggested to follow up on the remediation of the specific engagement. These peer review documents should be submitted for consideration during the peer review acceptance process. A reviewed firm's appropriately documented considerations in response to such an engagement and documentation of the reviewer's assessment of the reviewed firm's response are conditions of acceptance by the peer

[fn 8] All AR-C sections can be found in AICPA *Professional Standards*.

review committee. If the firm and peer reviewer considerations are not properly performed or documented, the RAB may defer acceptance of the peer review subject to appropriate considerations or peer review documentation.

Peer reviewers and administering entities should not require or instruct reviewed firms to perform omitted procedures, reissue accounting or auditing reports, or to have previously issued financial statements revised and reissued because those are decisions for the firm and its client to make. Firms are only required to remediate as appropriate in accordance with professional standards and are not expected to recall reports or perform additional procedures in every scenario. In general, if firms can articulate their consideration of the professional standards and why the actions taken or planned are appropriate, it would not result in a tone at the top deficiency. Firms are discouraged from defaulting to a response of "we'll fix it on the next engagement" without thought behind that response. It may be the appropriate response but firms should be able to articulate why that is the appropriate response.

If the firm determines that omitted procedures will be performed, that notifications will be made to those relying on the reports, or that financial statements will be revised or reissued prior to the peer reviewer's conclusion on the engagement or conclusion on the peer review, it is not expected that these actions will be completed before the peer review concludes. However, the firm's response should include its intention to perform these steps, if known. The RAB may require follow up action to evaluate the firm's follow through on the intended or alternative steps taken.

In a system review, if the team captain or RAB concludes that the firm's response and consideration of the applicable standards is not appropriate to address the nonconforming engagement, the team captain should evaluate whether there are other weaknesses in the firm's system. For example, an inappropriate response may be indicative of a potential failure to comply with the leadership or tone at the top element in the firm's system of quality control. A failure to properly consider how to address nonconforming engagements may indicate an internal firm culture that fails to promote that quality is essential in performing engagements.

In system and engagement reviews, if the peer reviewer concludes that the firm's considerations and response are appropriately documented related to such an engagement and the firm indicates in its response that it intends to complete omitted procedures, reissue the auditor's or accountant's report, or have previously issued financial statements revised and reissued, the RAB will consider whether the firm's response is genuine, comprehensive, and feasible. The RAB may consider requesting the firm submit evidence to an outside party acceptable to the RAB of performing and documenting the previously omitted procedures, reissuance of the report, or revision to the financial statements, if appropriate.

The firm's actions, taken or planned, may affect other monitoring actions that the RAB may impose. Additional guidance for determining when and what type of corrective

action(s) or implementation plan(s) a RAB may require is provided in chapters 4 and 5 of the *Report Acceptance Body Handbook*.

Peer Review Reports and Firm Representation Letters for System Reviews That Include Engagements Subject to *Government Auditing Standards* and the Single Audit Act [fn 9]

Firm representation letters and peer review reports for system peer reviews that include engagements subject to *Government Auditing Standards* (GAS) and the Single Audit Act should be tailored for the following situations.

1. Firms that perform audits subject to both GAS and the Single Audit Act.

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

The scenarios and illustrations that follow are not meant to address every situation and every combination of engagements selected and reviewed. Firm representation letters and peer review reports should be appropriately tailored to reflect engagements performed, selected, and reviewed.

Scenario 1 (firm performs audits subject to both GAS and the Single Audit Act)

The firm of Smith & Jones, LLP performed audits of a not-for-profit entity that is subject to *Government Auditing Standards* and the Single Audit Act. This firm also audited employee benefit plans. The financial statements of a not-for-profit entity and an 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 (Bobbye Kelly, CPA). The peer review year end was June 30, 20XX, and the exit conference was conducted on October 31, 20XX. The peer review report rating was pass. The firm's administering entity is the North Carolina Association of CPAs. The relevant sections are bolded for emphasis.

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

October 31, 20XX

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, 20XX.

[fn 9] The term Single Audit Act as it is used in this guidance is meant to refer to single audits performed under Uniform Guidance.

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 broker-dealers, and examinations of service organizations [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** [fn 10]

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

[fn 10] This wording is used when the reviewer satisfied the requirement to review an engagement performed in accordance with *Government Auditing Standards* and an engagement performed under the Single Audit Act by reviewing one engagement.

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

Peer Review Report With a Peer Review Rating of Pass in a System Review

Report on the Firm's System of Quality Control

October 31, 20XX

To the Partners of Smith & Jones, LLP and the Peer Review Committee of the North Carolina Association 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, 20XX. 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, [fn 11] **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, 20XX, 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 (firm performs engagements subject to GAS only in Addition to Audits Subject to both GAS and the Single Audit Act)

The firm of Smith & Jones, LLP performed audits of local governments that are performed in accordance with *Government Auditing Standards*. The local governments do not expend Federal funds. The firm also audited employee benefit plans and not-for-profit entities that are subject to *Government Auditing Standards* and the Single Audit Act. The financial statements of the local governments, the employee benefit plans, and the not-for-profit entities fell into the firm's peer review year. After consulting Interpretation 63-1, the peer reviewer (Bobbye Kelly, CPA) selected a local government and an employee benefit plan and also decided to review only the Single Audit portion of an audit of a not-for-profit entity. The peer review year end was June 30, 20XX, and the exit conference was conducted on October 31, 20XX. The peer review report rating was pass. The firm's administering entity is the North Carolina Association of CPAs. The relevant sections are bolded for emphasis.

[fn 11] **See footnote 10.**

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

October 31, 20XX

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, 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 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 broker-dealers, and examinations of service organizations [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** [fn 12]
3. **Audits of employee benefit plans**

[fn 12] This wording is used when the reviewer satisfied the requirement to review an engagement performed in accordance with *Government Auditing Standards* (GAS) and an engagement performed under the Single Audit Act by reviewing an audit performed in accordance with GAS and only the Single Audit portion of a separate engagement. See Interpretation 63-1.

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

Peer Review Report With a Peer Review Rating of Pass in a System Review

Report on the Firm's System of Quality Control

October 31, 20XX

To the Partners of Smith & Jones, LLP and the Peer Review Committee of the North Carolina Association 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, 20XX. 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, [fn 13] **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, 20XX, 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

Evaluation of Non-Compliance With the Risk Assessment Standards

Evaluation of Non-Conformity

Members of the ASB have stated that if an auditor fails to comply with the requirements of AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, or 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, then the objectives of these

[fn 13] **See footnote 12.**

standards would not be met. Accordingly, the audit would not be conducted in accordance with GAAS and the auditor would fail to obtain sufficient appropriate audit evidence to support the audit opinion. Therefore, it would be difficult to conclude that such an engagement conforms with professional standards from a peer review perspective and should be considered non-conforming.

Examples that would lead to non-conforming engagements:

- Failure to identify or document the identified risks of material misstatement (RMM), including any significant risks
  - Virtually every audit, including audits of small- and medium-sized entities, has at least one significant risk.
- Failure to assess or document the assessment of risk at both the relevant assertion level and financial statement level
  - A reviewer may encounter audits where the risks of material misstatement are assessed at the account level only rather than at the relevant assertion level.
  - Some practitioners confuse account-level risk with financial statement-level risk. Financial statement-level risks are not risks limited to one account balance, but rather, risks that are pervasive to the financial statements.
- Failure to properly document the firm's identification and assessment of the RMMs and response thereto
  - Reviewers should consider the linkage between the risk assessment and the auditor's procedures, and they should determine whether the procedures are responsive to the client's financial statement- and assertion-level risks.
  - Significant risks require special audit consideration, which means consideration above and beyond what a standardized audit program would address.
- Failure to evaluate the design and implementation of controls relevant to the audit
  - Auditors are expected to
    - consider what could go wrong as the client prepares their financial statements.

- identify the controls meant to mitigate those financial reporting risks.
- evaluate the likelihood that the controls are capable of effectively preventing or detecting and correcting material misstatements.

More detail of the proceeding examples can be found in the Internal Inspection Practice Aid.

Why the Risk Assessment Standards are an EAQ Theme

Data gathered from 2016 MFC forms shows that more than 1 in 10 firms failed to comply with AU-C section 315 or AU-C section 330. Through this and other means, we have become aware of a significant gap in the understanding of AU-C section 315 and AU-C section 330, even with firms that have robust systems of quality control.

Impact to the Peer Review

Currently, the standards only require that non-conforming engagements be communicated to the firm via an MFC form. **For peer reviews commencing October 1, 2018, through September 30, 2021, peer reviewers should comply with the following guidance (the following chart is an illustrative example):**

If the firm has any non-conforming engagements related to non-compliance with the risk assessment standards, and the non-compliance is not considered isolated, the reviewer should issue

- a finding if no deficiencies or significant deficiencies related to other issues are noted, even if all the engagements reviewed are non-conforming due to the risk assessment standards.
- a deficiency or significant deficiency if deficiencies and significant deficiencies related to other omitted audit procedures.

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	Systemic	Deficiency or Significant Deficiency with Corrective Action

Non-compliance noted	*Isolated or Systemic*	*Conclusion*
significant deficiencies exist that resulted in omitted audit procedures		

Additional Required Firm Actions

Currently, the standards do not require an implementation plan for an FFC with a non-conforming engagement. **When an FFC is required for non-compliance with the risk assessment standards, on reviews commencing October 1, 2018, through September 30, 2021, the RAB should issue the firm an implementation plan that requires one or more of the following:**

- CPE (webcast, other)
- Hire an outside party acceptable to the RAB to do the following:
  - Review the firm's mediation of an engagement not performed or reported on in conformity with the professional standards in all material respects
  - Perform a pre-issuance review(s)
  - Perform a post-issuance review(s)

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

Reviewer Performance Considerations

For reviews commencing 12/31/2018 or earlier, if a reviewer fails to identify issues involving non-compliance with the risk assessment standards, and thus fails to properly evaluate matters and identify an engagement as non-conforming it should be considered a reviewer performance finding as opposed to a potential reviewer performance deficiency.

For reviews commencing after 12/31/2018, if a reviewer fails to identify significant issues involving non-compliance with the risk assessment standards, and thus does not identify the engagement as non-conforming, RABs should follow the stated guidance in the RAB Handbook and issue a reviewer performance deficiency.

Regulatory Aspects of the Peer Review

Incomplete, Initial GAO Engagements in a System Review

If a firm is performing an initial engagement under *Government Auditing Standards* (GAS also known as the Yellow Book) that occurs in a firm's peer review year but is incomplete and without a comparable engagement, the firm can request an extension

from the administering entity and the U.S. Government Accountability Office (GAO; formerly U.S. General Accounting Office). However, if the GAO will not grant the extension, the firm will have to proceed with its peer review and receive a report (*pass, pass with deficiency* or *fail*, depending on the peer review results) with a scope limitation. A waiver of a scope limitation is not generally appropriate in this situation.

Government Auditing Standards CPE Requirements and Peer Review Requirements

Some firms with engagements subject to GAS tend to spend a limited number of hours on the engagements, have limited partner involvement, and often have limited CPE in the governmental area

Reviewers should consider the degree of noncompliance with the CPE requirements and the pattern and pervasiveness of matters, as well as their implications for compliance with the firm's system of quality control, in addition to their nature, causes, and relative importance in the specific circumstances in which they were observed. Reviewers should also ensure that the CPE deficiencies noted on the FFC forms provide enough detail so that committees can determine whether the findings are appropriate. Some reviewers may have been improperly concluding personnel lack or do not have appropriate governmental CPE when in fact they had accounting and auditing CPE, which in certain circumstances counts as governmental CPE.

If a firm conducts a governmental audit when the required personnel are not in compliance with the CPE requirements set forth in those standards,

1. consideration should be given to reporting the failure on a FFC form even if there are no other problems with the engagement.

2. consideration should be given to issuing a report with a rating of *pass with deficiency* related to personnel management if deficiencies are noted on the engagement or the noncompliance with CPE requirements rises to the level of a deficiency.

3. firms should be advised to obtain the required CPE before performing another government engagement.

Keep in mind, if a firm is performing governmental engagements and the firm does not have a quality or peer review done on the firm every three years, or the required personnel did not complete the CPE required by GAS, the engagements should be classified as not conforming with professional standards for purposes of the AICPA Peer Review Program.

Comparison of AICPA, GAO, and DOL Rules of Independence

Peer reviewers and technical reviewers need to be aware of the differences between the independence rules of the AICPA, GAO, and Department of Labor (DOL).

A chart has been developed comparing the AICPA rules of independence to the GAO rules of independence as they relate to nonattest services. The chart is divided among various categories of nonattest services: overarching principle, bookkeeping services, payroll services, appraisal and valuation services, information technology services, and human resources services. It is located at www.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/2012mayaicpagaocomparision.pdf.

In addition, a chart has been developed comparing the AICPA rules of independence to the DOL rules. It is located at www.aicpa.org/interestareas/employeebenefitplanauditquality/resources/accountingandauditingresourcecenters/auditorindependence/downloadabledocuments/dol_aicpa_independence_rule_comparison.pdf.

Reviewers should be aware of these differences when reviewing GAO and DOL engagements. Any GAO or DOL engagement where independence has been impaired, under any of the rules of independence, should be deemed as not in compliance with professional standards for AICPA Peer Review Program purposes.

Implications of the 2011 Yellow Book and Performance of Nonaudit Services

The AICPA Peer Review Board (board) has determined that when a firm performs an engagement in accordance with *Government Auditing Standards* when independence is impaired, the engagement would be deemed as not being performed or reported on in conformity with applicable professional standards in all material respects. However, a firm failing to comply with the documentation requirements of the December 2011 Revision of *Government Auditing Standards* (2011 Yellow Book) does not necessarily impair independence (see paragraph 3.59 of the 2011 Yellow Book) and further inquiries by the reviewer are required if independence impairments existed. The 2011 Yellow Book contains additional requirements beyond those required under AICPA Ethics Interpretation No. 101-3. Documentation of compliance with those requirements is explicitly required. Therefore, material noncompliance with either the independence evaluation or the documentation requirements of the 2011 Yellow Book results in the engagement being deemed as not performed or reported on in conformity with applicable professional standards in all material respects. There are several resources available through the Governmental Audit Quality Center that discuss the 2011 Yellow Book, including archived web events and practice aids that are free and available to all AICPA members at the following link:

https://www.aicpa.org/interestareas/governmentalauditquality/resources/auditpracticetoolsaids/yellowbookaudittoolsandaids.html.

The board has considered the impact of noncompliance with the 2011 Yellow Book on system reviews. Peer reviewers should take the following question and answer guidance and accompanying decision tree into consideration.

Evaluation of a Firm's Compliance with 2011 Yellow Book Independence Requirements Related to Nonaudit Services

Question and Answer for Peer Reviewers

Note to Reviewer: The following are key differences in applying AICPA Ethics Interpretation No. 101-3 and the 2011 Yellow Book that peer reviewers need to be aware:

- The 2011 Yellow Book requires documentation of the assessment of management's ability to oversee the nonaudit services, including whether management has suitable skills, knowledge, or experience (SKE); AICPA Ethics Interpretation No. 101-3 requires the same assessment, but does not require documentation of the assessment. However, the conclusion as to management's ability to oversee the nonaudit services should be the same under both standards.

- The 2011 Yellow Book requires consideration of threats in the aggregate with other nonaudit services provided. This concept is not currently included in AICPA Ethics Interpretation No. 101-3.

- The 2011 Yellow Book requires that any and all nonaudit services that are not prohibited, regardless of significance, be assessed using the Yellow Book Conceptual Framework. Therefore, all nonaudit services must be evaluated for threats and safeguards must be applied when threats are deemed to be significant. However, under AICPA Ethics Interpretation No. 101-3 for nonattest services listed as permitted, as long as the auditor complies with the general requirements for performing nonattest services, no further assessments of threats or application of safeguards are required.

- The 2011 Yellow Book specifically defines preparation of financial statements and cash to accrual entries as nonaudit services subject to 2011 Yellow Book independence evaluation and documentation requirements. Under a nonauthoritative Frequently Asked Questions to AICPA Ethics Interpretation No. 101-3, those services are defined as routine services and only require that auditors not assume management responsibilities when performing such services. Recently adopted revisions to Ethics Interpretation No. 101-3 specifically identify activities such as financial statement preparation, cash-to-accrual conversions, and reconciliations as nonattest services effective for engagements covering periods beginning on or after December 15, 2014.

- To see the current comparison of AICPA versus GAO Independence Rules, refer to

www.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/2012mayaicpagaocomparision.pdf. Please note that there is currently an exposure draft (dated August 31, 2012) that would revise AICPA Ethics Interpretation No. 101-3 to require evaluation of threats in the aggregate. See https://www.aicpa.org/interestareas/professionalethics/community/exposuredrafts.html for the current status of the exposure draft.

1. What engagements does the 2011 Yellow Book apply to?

The 2011 Yellow Book applies to financial audits and attestation engagements conducted in accordance with *Government Auditing Standards* performed for periods ending on or after December 15, 2012. However, auditors performing nonaudit services must be independent for the period covered by the financial statements. Therefore, auditors may be required to comply with the 2011 Yellow Book independence requirements for nonaudit services performed as early as January 1, 2012. The 2011 Yellow Book also applies to performance audits conducted in accordance with *Government Auditing Standards* for audits beginning on or after December 15, 2011.

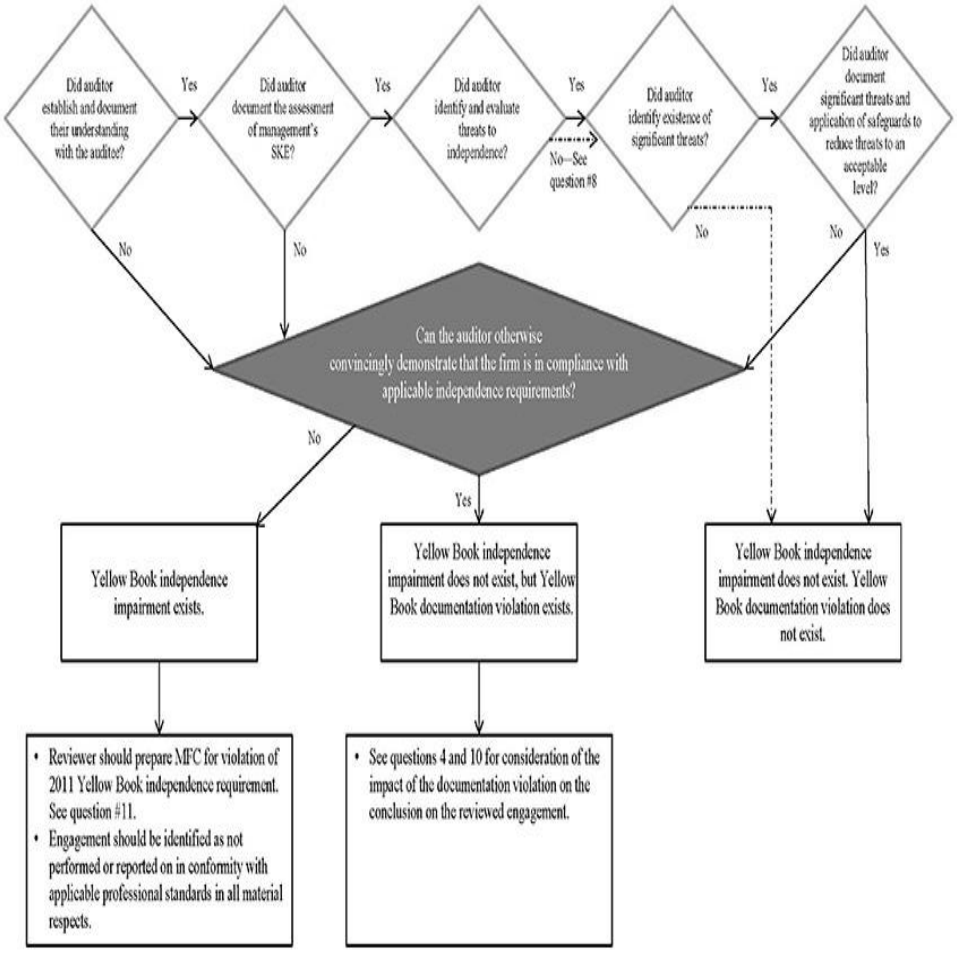
2. Is a firm required to complete the AICPA *2011 Yellow Book Independence—Nonaudit Services Documentation Practice Aid* or other third party standardized forms in order to evidence the firm's independence in the performance of nonaudit services performed for an auditee under the December 2011 revision to *Government Auditing Standards* (the 2011 Yellow Book)?

No. The *2011 Yellow Book Independence—Nonaudit Services Documentation Practice Aid* was developed to assist auditors in meeting the requirements in the 2011 Yellow Book for identifying and evaluating threats to independence when considering whether to provide a nonaudit service. An auditor could use various approaches to meet the independence evaluation and documentation requirements of the 2011 Yellow Book; therefore, use of the AICPA practice aid or any other third party provided practice aid is not required by professional standards. Peer reviewers should obtain an understanding of the firm's internal quality control policies and procedures to meet the applicable professional requirements. The peer reviewer should evaluate whether the firm's methodology for meeting the requirements is appropriate.

Peer reviewers should note that the documentation requirement for assessment of the skills, knowledge, and experience of the individual at the auditee designated to oversee a nonaudit service will not be compliant simply through management representations or other actions performed solely by the audited entity. This requirement is applicable for any and all permitted nonaudit services, regardless of significance. Auditors are expected to document an assessment under the standards, therefore completion of a checklist that does not provide for documentation of the actual evaluation will be unlikely to comply with the standards.

3. Is there a tool that peer reviewers can utilize to evaluate a firm's compliance with the 2011 Yellow Book independence requirement related to nonaudit services?

Yes. This Q&A document provides guidance to assist peer reviewers in evaluating a firm's compliance with the 2011 Yellow Book independence requirement related to nonaudit services. The following chart in exhibit A should be used in conjunction with the interpretive guidance for peer reviews.



4. Is a failure to comply with the documentation requirements regarding independence in the 2011 Yellow Book considered a departure from professional standards?

Yes. The 2011 Yellow Book emphasizes that documentation is required for the evaluation of each of the elements of independence, which consists of management's ability to oversee the nonaudit services, including whether management has SKE, significant threats that require the application of safeguards along with the safeguards applied, and the understanding established with the audited entity regarding the nonaudit

services to be performed. Failure to document one or more of these elements is considered a departure from professional standards.

The examples provided are intended to assist the peer reviewer in determining whether there is a departure from professional standards and the impact of that departure on the engagement. However, examples cannot contemplate every circumstance a peer reviewer might face and are not a substitute for professional judgment. The peer reviewer is likely to encounter situations where the engagement is somewhere on a continuum of compliance with standards. If there is a failure to document one or more of the elements of the independence evaluation required by the 2011 Yellow Book, ordinarily the engagement should be considered as not performed in conformity with applicable professional standards in all material respects. If there is marginal documentation of a particular element required by professional standards, the peer reviewer should use judgment to determine the degree of noncompliance on the conclusion of the engagement.

5. If a peer reviewer is reviewing an engagement and determines that independence is not documented in accordance with paragraph 3.59 of the 2011 Yellow Book, should the reviewer automatically conclude that there are independence impairments?

No. A documentation failure does not automatically indicate independence impairment. In a situation in which an independence documentation deficiency exists, the peer reviewer will need to perform additional inquiries of the firm to determine whether independence was impaired. In this case, a MFC will be required to document the peer reviewer and firm's assessment of the noncompliance, whether or not it rises to the level of independence impairment. If the conclusion is reached that there is either a documentation failure or independence is impaired, the reviewer should refer to questions 10 and 11.

6. How can a reviewer evaluate whether noncompliance with the documentation requirements of the 2011 Yellow Book indicates that independence is impaired?

If the firm failed to document all of the components required by *Government Auditing Standards* (that is, management's ability to oversee the nonaudit services, including whether management has SKE, significant threats that require the application of safeguards, and the understanding established with the audited entity regarding the nonaudit services to be performed), the reviewer should presume that independence was impaired. However, the audit firm may be able to provide convincing evidence that the lack of documentation does not indicate independence impairments.

Reviewers should make the initial inquiries of the firm verbally and timely. This will help the reviewer determine the underlying cause of the failure and genuineness of the firm's response. The firm can subsequently provide a written response to support the oral claims. However, if the audit firm indicates the auditee did not have anyone with

sufficient SKE to oversee the nonaudit services performed, then a significant threat existed for which no safeguards to overcome the threat were available and conclusive proof exists that independence was impaired.

7. Can the firm otherwise demonstrate that it is independent although management's ability to oversee the nonaudit services, including whether they have SKE, is not properly documented?

Yes. However, the burden of proof required of the firm to evidence such compliance is high and the firm will need to provide the reviewer with persuasive evidence that independence was not impaired.

Example 7.1

The auditor established and documented the understanding with the auditee regarding the nonaudit services in accordance with paragraph 3.39 of the 2011 Yellow Book, but failed to document consideration of management's SKE. Upon inquiry by the reviewer, the auditor was able to demonstrate that the SKE of the CFO responsible for oversight of the nonaudit service was common knowledge to the auditor because of extensive history and experience with the auditee and the CFO. The reviewer should evaluate the evidence based on the totality of the situation to determine whether the firm met the burden of proof to support its claims that it had appropriately considered and complied with the independence requirements. In this case, the reviewer might reach the conclusion that the firm failed to conform with the 2011 Yellow Book by failing to document the considerations required, but that the firm's independence was not impaired. This engagement would be considered, not performed or reported on, in conformity with applicable professional standards in all material respects for failing to comply with the documentation requirements of the 2011 Yellow Book (see question 10for additional information).

Example 7.2

The auditor established and documented the understanding with the auditee regarding the nonaudit services in accordance with paragraph 3.39 of the 2011 Yellow Book, but failed to document consideration of management's SKE. Upon inquiry by the reviewer, the auditor was unable to provide persuasive evidence that the individual at the auditee responsible for overseeing the nonaudit service had SKE. In this case, the reviewer would likely reach the conclusion that the firm failed to conform with professional standards because the firm failed to document the considerations required and the firm was not independent because an individual with sufficient SKE did not oversee the performance of the nonaudit service. This engagement would be considered, not performed or reported on, in conformity with applicable professional standards in all material respects for failing to comply with the independence requirements of the 2011 Yellow Book (see question 11 for additional information).

8. Under what circumstances should the peer reviewer question the audit firm's evaluation of threats and documentation (or lack thereof) of safeguards to reduce threats to an acceptable level?

The 2011 Yellow Book does not require documentation of the evaluation of threats unless the threats are deemed significant enough to require the application of safeguards. If there is contradictory evidence that would appear to refute the auditor's claim that a threat is not significant, the reviewer should consider whether the audit firm's evaluation of the threat was appropriate through inquiries of the firm. If the threats are deemed to be significant, the reviewer will need to determine whether safeguards had been applied that reduced the threats to an acceptable level. If the reviewer determined that significant threats existed and safeguards were applied that reduced the threats to an acceptable level, but the firm failed to document the consideration of the threats and the application of safeguards, the reviewer may reach a conclusion that the firm was independent but failed to comply with professional standards by not documenting its independence considerations. If the reviewer determines that significant threats existed and safeguards were not applied, this would indicate independence impairment.

Factors to consider that may indicate significant threats exist include the following:

- Performance of multiple nonaudit services
- Nonaudit services that are significant to the subject matter of the audit
- Significant assumptions and judgments made by the auditor
- Significant degree of subjectivity related to the nonaudit service
- Poor condition of the audited entity's books and records

Threats must be evaluated in the aggregate as well as individually when assessing the significance of the threats.

The Government Accountability Office has indicated that, in its view, other than in very limited circumstances, preparing financial statements for an auditee would result in a significant threat for which safeguards should be applied and documented.

Example 8.1

The auditor prepared the financial statements for the auditee and this was the only nonaudit service performed. The auditor had documented the requirements under paragraphs 3.37 and 3.39 of the 2011 Yellow Book, including evaluation that the individual designated by the audited entity who oversees the preparation of the financial statements possessed SKE sufficient to oversee the service. The auditor did not identify any significant threats to independence and thus did not document that any safeguards

had been applied to reduce significant threats to an acceptable level. In this circumstance, the reviewer may want to make additional inquiries of the firm as to whether they considered financial statement preparation to be a significant threat requiring the application of safeguards. The reviewer should evaluate whether the firm considered threats in relation to the nonaudit service performed, whether safeguards were applied but not documented, and whether the firm reached an appropriate conclusion as to the significance of the threats. In this situation, the reviewer might reach one of the following conclusions:

1. The firm reached an appropriate conclusion that threats were not significant (however, see the paragraph regarding GAO's position on significance of threats for non-audit services related to preparation of financial statements).

2. The firm did not reach an appropriate conclusion that threats were not significant and therefore did not document its assessment of threats or application of safeguards. However, the firm appropriately applied safeguards sufficient to reduce the threat(s) to an acceptable level which would result in noncompliance with professional standards but not independence impairment.

3. The firm did not reach an appropriate conclusion that threats were not significant and failed to apply safeguards to reduce significant threats to an acceptable level. Therefore, independence would be considered impaired.

Example 8.2

The auditor prepares the financial statements for the auditee and this was the only nonaudit service performed. The auditor had documented the requirements under paragraphs 3.37 and 3.39 of the 2011 Yellow Book, including evaluation that the individual designated by the audited entity who oversees the preparation of the financial statements possessed SKE sufficient to oversee the service. The auditor did not identify any significant threats to independence and thus did not document that any safeguards had been applied to reduce significant threats to an acceptable level. The reviewer noted that the auditor also proposed a significant number of material correcting journal entries in order to make the books and records complete and accurate. In this circumstance, the reviewer may reach a conclusion that threats were significant, considering that the nonaudit service is significant to the subject matter of the audit and that the books and records appear to be in a poor condition. In this circumstance, the reviewer would need to determine if appropriate safeguards were applied to reduce threats to an acceptable level in determining whether this noncompliance with professional standards rises to the level of independence impairment.

9. How should the reviewer evaluate other evidence in the working papers that may contradict conclusions that the auditor has reached regarding independence evaluations?

Evaluation of independence is a process that must be continuously evaluated during the entire period of the audit. Circumstances can arise that would cause a firm to re-evaluate its independence considerations, and reviewers need to be alert to evidence in the working papers that may have required a firm to perform such reconsideration.

Example 9.1

The auditor had documented its evaluation that there was sufficient SKE at the auditee to oversee the nonaudit service(s) performed. The reviewer noted that there were a significant number of material audit adjustments proposed during the audit. In addition, the auditor had to correct a number of reconciliations prepared by the auditee. The adjustments and the reconciliations related to the job responsibilities of the individual who was designated to oversee the nonaudit service(s) performed. In this circumstance, the reviewer should make additional inquiries of the firm to determine if the auditor had considered the need to re-evaluate the SKE of the designated individual as a result of these adjustments and corrections.

Example 9.2

The auditor documented his or her evaluation that there was sufficient SKE at the auditee to oversee the auditor's preparation of the financial statements as a nonaudit service. The reviewer noted that the auditor had identified a material weakness in internal control over the auditee's inability to prepare GAAP-based financial statements. In this circumstance, the reviewer may choose to make additional inquiries of the firm to determine if they had considered the need to re-evaluate the SKE of the designated individual as a result of the material weakness. The reviewer should assess whether the identified material weakness in internal controls results from the auditee's inability to re-perform the service as opposed to its inability to effectively oversee the performance of the service. For purposes of complying with the independence requirements, the 2011 Yellow Book does not require SKE sufficient to re-perform the service. If the reviewer determines that the material weakness relates to the auditee's inability to prepare the GAAP-based financial statements, but the auditee is capable of overseeing the service, then no further action is necessary. However, if the reviewer determines that the material weakness is an indicator that the auditee did not designate someone with sufficient SKE to oversee the nonaudit service, then the reviewer should conclude that independence was impaired as no sufficient safeguards were present to overcome the significant threats that existed at the time the nonaudit service was performed.

10. If the peer reviewer determines that there is a failure to comply with the documentation requirements of the 2011 Yellow Book, what is the impact on the peer review and what are the responsibilities of the reviewed firm?

The peer reviewer should make inquiries of the audit firm in such a way as to (*a*) make an initial determination about whether the auditor understood, had awareness of, and considered all independence requirements of the 2011 Yellow Book and, if so, (*b*) reach a

conclusion as to whether the documentation failure rises to the level of independence impairment. The reviewer's inquiries should be such that the reviewer can identify the cause of the documentation failure.

If the peer reviewer concludes that there is a documentation failure, the peer reviewer should remind the firm of its responsibilities under AU-C section 585 (previously AU section 390). The peer reviewer should further ascertain if independence was impaired and expect a prompt response to support the auditor's assertion that independence was not impaired. If the reviewer subsequently concludes that the audit firm has sufficiently demonstrated compliance with applicable independence elements (auditee had sufficient SKE, significant threats were mitigated by suitable safeguards, and an understanding was established with the audited entity regarding the nonaudit services to be performed), the audit firm should also take appropriate action to revise documentation in accordance with AU-C section 230, *Audit Documentation* (previously SAS 103 and AU section 339), in order to comply with the 2011 Yellow Book independence requirements.

Due to a firm's failure to materially comply with the documentation requirements of the 2011 Yellow Book, the reviewed engagement would be considered not performed or reported on in conformity with applicable professional standards in all material respects. Accordingly, the peer reviewer should ordinarily prepare a MFC Form to which the reviewed firm must respond. (Refer to Interpretation No. 67-1, "Concluding on the Review of an Engagement.") The reviewed firm should include the actions taken or planned regarding the engagement on the MFC form. The reviewer should indicate whether the reviewer concurs with the firm's response, actions, or planned actions within section IV of the Summary Review Memorandum.

11. If the reviewer and the firm reach a conclusion that independence is impaired, what is the impact on the peer review and what are the responsibilities of the reviewed firm?

If the firm cannot provide sufficient evidence to demonstrate that the firm was independent, then the engagement is not performed or reported on in conformity with the 2011 Yellow Book in all material respects. Lack of independence on an audit engagement requires the auditor to take all appropriate steps under professional standards which may include preventing further reliance on the auditors 'report, or revising and reissuing the auditors 'report. The peer reviewer should remind the firm of its responsibilities under AU-C section 585 (previously AU section 390), and AU-C section 560, *Subsequent Events and Subsequently Discovered Facts* (previously AU 561), regarding potential retraction of the engagement.

Additionally, as stated in paragraph 3.26 of the 2011 Yellow Book:

> [i]f a threat to independence is initially identified after the auditors 'report is issued, the auditor should evaluate the threat's impact on the audit and on GAGAS compliance. If the auditors determine that the newly identified threat had

> an impact on the audit that would have resulted in the auditors ’report being different from the report issued had the auditors been aware of it, they should communicate in the same manner as that used to originally distribute the report to those charged with governance, the appropriate officials of the audited entity, the appropriate officials of the organizations requiring or arranging for the audits, and other known users, so that they do not continue to rely on findings or conclusions that were impacted by the threat to independence. If the report was previously posted to the auditors ’publicly accessible website, the auditors should remove the report and post a public notification that the report was removed. The auditors should then determine whether to conduct additional audit work necessary to reissue the report, including any revised findings or conclusions or repost the original report if the additional audit work does not result in a change in findings or conclusions.

If the threat to independence cannot be reduced to an acceptable level, even if additional procedures are performed, the auditor should take appropriate steps under professional standards to prevent further reliance on the auditors ’report. Due to a firm’s failure to materially comply with the independence requirements of the 2011 Yellow Book, the reviewed engagement would be considered, not performed or reported on, in conformity with applicable professional standards in all material respects. Accordingly, the peer reviewer should ordinarily prepare a MFC Form to which the reviewed firm must respond. The reviewed firm should include the actions taken or planned regarding the engagement on the MFC form. The reviewer should indicate whether the reviewer concurs with the firm’s response, actions, or planned actions within section IV of the Summary Review Memorandum.

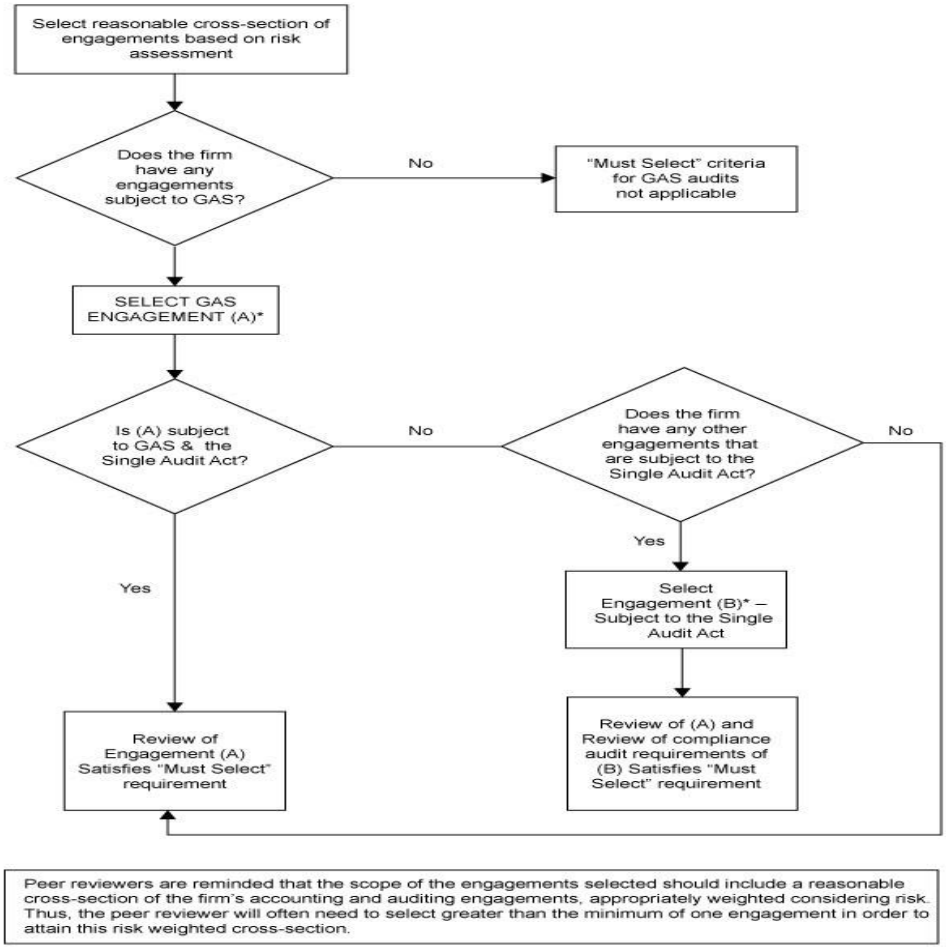
Selection of a Single Audit Engagement for Review of Compliance Testing

Peer Review Standards Interpretation No. 63-1a requires that at least one engagement subject to *Government Auditing Standards* (GAS) be reviewed. The interpretation additionally requires that if the engagement selected is of an entity subject to GAS but not subject to the Single Audit Act and the firm performs engagements of entities subject to the Single Audit Act, at least one such engagement should also be selected for review. The review of this additional engagement must evaluate the compliance audit requirements and may exclude those audit procedures strictly related to the audit of the financial statements.

The review team is not required to select a single audit engagement to review in its entirety. (See flowchart on next page regarding selection of engagements to review.) However, if the firm has both single audit engagements and engagements subject only to GAS and the review team selects an engagement subject only to GAS to review, the review team must also select at least one single audit engagement to evaluate the firm’s compliance with single audit requirements (such as determination of major programs, audit procedures designed and performed in accordance with the applicable compliance supplement, reporting on the schedule of expenditures of federal awards, and so on). The

number of single audit engagements selected for review will be based upon the judgment of the review team considering its assessment of risk relative to the single audit engagements performed by the firm. The reviewer should complete the Supplemental Checklist for Review of Single Audit Engagements for the single audit engagement (s) selected to review.

Interpretation No. 63-1 — "Must Select" — Subject to *Government Auditing Standards* (GAS)



As always, the selection of engagements should be performed using the risk-based approach, and the engagement selection should also provide a reasonable cross-section of the firm's accounting, auditing, and attestation engagements. Inclusion of a must select engagement should not impact the reviewer's consideration of engagements and industries that have a significant public interest. As an example, if for-profit HUD multifamily housing project audit engagements constitute a significant percentage of a firm's practice, one would expect the reviewer to select at least one such engagement for review. However, if the firm also performed an audit of an engagement subject to the Single Audit Act (such as a local government or not-for-profit organization), such

engagement must also be selected and an evaluation of the firm's single audit compliance made. The review of this additional engagement must evaluate the compliance audit requirements and may exclude those audit procedures strictly related to the audit of the financial statements.

If during the course of the review of the single audit engagement, the review team concludes there was a failure to reach an appropriate conclusion on the application of professional standards in all material respects, the review team should consider whether the application of additional review procedures is necessary. For example, if the firm fails to test a major program due to failure to properly select major programs, the review team should consider reviewing the major program selection working papers for another single audit engagement. If, during the review of compliance testing or other procedures, the reviewer determines the firm's performance did not conform to professional standards, the reviewer should also consider the need to review the audit of the financial statements of the selected single audit engagement. For additional guidance on expansion of scope, see paragraph .42 of section 4200 of the Peer Review Program Manual.

This requirement is effective for all peer reviews commencing on or after September 1, 2009 though early implementation is encouraged.

Responding to Single Audit Engagements Not Performed or Reported on in Conformity With Applicable Professional Standards in all Material Respects

In response to the National Single Audit Sampling Project report issued by the President's Council on Integrity and Efficiency (PCIE), the AICPA formed seven task forces, one of which is the Practice Monitoring Task Force — A-133 Subgroup.

The task force is studying the results of the PCIE report to determine ways in which the peer review process can aid in enhancing the quality of performance of OMB Circular A-133 (A-133) audits by member firms. The Peer Review Board has already implemented several task force recommendations including a revised "must select" interpretation for A-133 engagements, a bifurcated A-133 peer review checklist to focus on the areas identified in the PCIE report, and an enhanced report acceptance process for peer reviews including these engagements.

The task force recognizes the need for guidance to peer reviewers and RABs on the need for recall and reissue of single audit compliance reports when a peer review finds that such engagements are not performed and reported on in accordance with professional standards in all material respects. Such reissuances may result because the peer reviewer determines that the firm missed auditing a major program due to improper risk based major program determination, failure to properly identify the low risk auditee status of the auditee resulting in a missed major program, failure to test internal controls over compliance or compliance, and other examples included in subsequent paragraphs.

If an error is found that results in the addition of a major program, performance of the appropriate testing on the new major program should be conducted. When the auditor determines that additional procedures are necessary, the auditor should refer to AU-C section 585 for additional guidance.

If, subsequent to issuing the single audit report, the auditor becomes aware that facts may have existed at the time of the single audit that might have affected the reporting had they been known at the time, the auditor should refer to AU-C section 560 for additional guidance.

If the auditor decides to reissue the compliance report, the auditor should refer to paragraph .43 of AU-C section 935, *Compliance Audits*.

When the auditor becomes aware of such concerns or other concerns after issuing the single audit reporting, an understanding of the scenario and its effect should be gained in order to determine the following:

- whether the auditor should perform additional audit procedures;
- whether the Schedule of Expenditures of Federal Awards (SEFA) must be revised by the auditee and the impact on the in-relation-to reporting on the SEFA;
- the impact on the single audit report on compliance with requirements applicable to each major program and on internal control over compliance in accordance with OMB Circular A-133 and whether such report should be reissued;
- the impact on the report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with GAS and whether such report should be reissued.
- whether the Data Collection Form should be revised and resubmitted;
- whether the Schedule of Findings and Questioned Costs should be modified by the auditor;

Additional guidance on the steps that a firm should take when it is required to re-audit and reissue can be found at the Governmental Audit Quality website.

Examples of the issues that arise that cause the team captain to consider whether a firm should perform additional audit procedures and reissue the prior year single audit reporting include the following:

1. Missed major program due to improper risk assessment (two-year look-back rule, including American Recovery and Reinvestment Act funding)
2. Improper clustering of programs resulting in a missed major program

3. Failure to include and audit all programs with same catalog for domestic federal assistance (CFDA) number when determining major programs

4. Failure to meet the percentage of coverage required (50% or 25% depending on low risk auditee status)

5. Failure to properly compute the program type A/B threshold determination resulting in a missed major program or incorrect program selection

6. Improperly classifying an entity as a low-risk auditee resulting in missed major programs due to percentage of coverage audited as major

7. Inadequate testing of internal over compliance (for example, not testing to support a low-assessed level of control risk, not testing controls relating to some direct and material compliance requirements, or inappropriate sample sizes or related documentation) or compliance (for example, failure to test compliance for all direct and material compliance requirements or inappropriate sample sizes or related documentation) to support the major program opinion

The instances that follow may also result in a consideration to re-audit and reissue the compliance report depending on the severity of the issue.

1. Incorrect or inconsistent summary of auditor results. This includes incorrect reporting of report qualifications, major programs selected, type A threshold amounts, and low risk auditee status. Usually these could be considered "editorial" errors but if substantive, could elevate to major significance.

2. Missing CFDA numbers on SEFA (or pass-through entity numbers omitted)

3. SEFA not totaled properly

4. Incorrect auditor reports (for example, language used inconsistent with AU-C section 265; language used inconsistent with AU-C section 935; missing reporting elements, and so on)

5. SEFA missing required footnotes

In these circumstances when it is concluded that a single audit engagement is not performed in accordance with professional standards in all material respects, ordinarily the firm should recall and reissue the applicable reports. Otherwise the firm should document its considerations not to recall and reissue. Reviewers should thoroughly evaluate a firm's decision not to recall and reissue the applicable reports and indicate if the reviewer agrees or disagrees with the firm's decision. Further, if the reviewer disagrees with the firm's actions in consideration of the applicable standards or its decision not to recall and reissue, the reviewer should evaluate whether this is indicative of a potential leadership or tone at the top deficiency.

October 2020

Non-Securities and Exchange Commission Issuer Entities Subject to Securities and Exchange Commission and Public Company Accounting Oversight Board Independence Rules

The Securities and Exchange Commission or the FDIC have specified that either or both of the SEC and PCAOB independence rules are applicable to the auditors of non-SEC issuer entities subject to the Federal Deposit Insurance Corporation Act (FDICIA) (for example, banks, saving institutions, and so on), brokers, dealers, and investment advisers. Per FIL-33-2009, independent public accountants that perform audit and attest services for insured depository institutions subject to Part 363 of the FDIC Rules and Regulations (FDICIA) must comply with the independence standards and interpretations of the AICPA, the SEC, and the PCAOB. To the extent that any of the rules within these independence standards is more or less restrictive than the corresponding rule in the other independence standards, the independent public accountant must comply with the more restrictive rule.

The independence rules applicable to auditors of non-SEC issuer brokers, dealers, and investment advisers are narrower in scope. Currently, only the SEC independence rules prohibiting nonaudit services are relevant.

As a result, these engagements are separately identified on the Summary Review Memorandum (SRM), as either "Federal Deposit Insurance Corporation Improvement Act (FDICIA)" or "Entities Subject to Security Exchange Commission (SEC) Independence Rules." "Entities Subject to Securities and Exchange Commission (SEC) Independence Rules" are further broken down into "Carrying Broker-Dealers," "Non-carrying Broker-Dealers," and "Other." It is important to separate these statistics in the appropriate categories, versus including them in the "Other SAS Engagements" category, to ensure that the team captain considers whether the engagement selections for the peer review contain a reasonable cross-section of the reviewed firm's accounting and auditing practice, with greater emphasis on those engagements in the practice with a higher assessed level of peer review risk. It is also important to ensure that the appropriate procedures are performed during the review of the engagement.

Please note that auditors of non-issuers that elect to report under the PCAOB standards are not subject to PCAOB independence rules. However, if a non-issuer chooses to have its report issued under the standards of the PCAOB (without the explicit reference to "auditing standards"), then the auditor is expected to comply with all of the PCAOB's standards, including independence rules. See the PCAOB Q&A on this topic at: http://pcaobus.org/standards/qanda/06-30-2004.pdf.

For additional information on the independence requirements applicable to FDICIA entities, please visit www.fdic.gov/news/news/financial/2009/fil09033.html. For additional information on the independence rules applicable to brokers, dealers, and investment advisers, please visit www.sec.gov/info/accountants/ocafaqaudind080607.htm. The SEC independence rules

are available at https://www.sec.gov/rules/final/33-8183.htm; the PCAOB independence rules are available at http://pcaobus.org/rules/pcaobrules/pages/section_3.aspx#rule3520.

Considering the Firm's Monitoring Procedures

Interpretation No. 45-2, "Considering the Firm's Monitoring Procedures" of PR section 100, *Standards for Performing and Reporting on Peer Reviews* (PR sec. 9100), [fn 14] provides that a review team may reduce the scope of the peer review if they have concluded on the effectiveness of the reviewed firm's current year internal inspection procedures. To what extent may the scope be reduced, and what factors must be considered and steps performed in order to conclude on the effectiveness? In addition, may a review team apply this same guidance to the involvement of and results from regulatory oversight?

These questions have become more relevant due to changes in the environment in which certain peer reviews are being performed, including increased rigor and robustness of those firm's monitoring processes and internal inspection programs in response to regulatory inspections and reviews. For some firms, a more continuous stream of information regarding the firm's system of quality control is now available from different parties — peer reviewers, internal inspectors, and regulators. For some firms, results from these sources could be similar, and, as a result, there could be an overlap in procedures and duplications of effort, particularly when the firm's system of quality control does not distinguish between SEC and non-SEC engagements in any significant way.

If a firm and its peer reviewer work more collaboratively and with an integrated approach, regardless of the size of the firm, the peer reviewer could maximize his or her consideration of a firm's current year internal inspection and other relevant factors (for example, regulatory oversight from the PCAOB or other regulatory or governmental entities, such as the DOL, HHS, or local regulatory agencies) in determining inherent and control risk. At the same time, this guidance establishes parameters to ensure that peer reviewers only reduce the scope of their direct work when specifically warranted.

Any changes to the peer review process that result from implementing this guidance may be viewed as a reallocation of efforts and resources. The peer review's scope will continue to include a well-planned cross-section of the firm's accounting and auditing engagements, appropriately weighted towards risks. The overall scope and the efforts involved are not diminished, just made more efficient and effective. The resulting peer review will remain as rigorous as a peer review where there is no consideration of the firm's internal inspection process.

[fn 14] All PR sections can be found in AICPA *Professional Standards*.

Cost-Benefit Considerations

Because there are cost-benefit considerations for firms to consider, peer reviewers should discuss this guidance with firms to determine its applicability and practicality. For firms that already have a robust internal inspection program in the year of the peer review, peer review procedures could likely be reduced. For firms that do not already have a robust internal inspection program in the year of the peer review, it provides the opportunity for the firm to reallocate some of the effort from peer reviewers to its internal inspectors. However, for other firms, because of their size or other factors, performing an internal inspection in the year of the peer review, or making the internal inspection procedures more robust to facilitate some reduction in peer review scope, might not be cost-beneficial.

An added benefit of the integrated approach contemplated within this guidance is the education, training, and insight internal inspectors can gain into their own firm's design and compliance with its system of quality control from working more closely with the peer reviewer. At the same time, the peer reviewer gains more insight from working more closely with those who understand the firm best.

Just as firms 'internal inspections differ, not all firms are subject to the same level of regulatory oversight or involvement from other governmental bodies. Some may be subject to regulatory or governmental oversights or inspections, such as PCAOB inspections or DOL oversights or reviews. In all cases, consideration of any or all of these influences (as well as others that may be applicable) should be evaluated by the peer reviewer and the firm to determine if they impact the risk-based analysis upon which the scope of the peer review is based, while also considering corresponding costs and benefits.

The firm's cooperation is crucial; it must be willing and able to share information, whether from its internal inspectors, regulators, or other governmental bodies, with the peer reviewer.

Factors to Consider

A number of factors should be considered in assessing the impact of proposed changes on the scope of the work that the peer reviewer performs directly. The more positive factors a peer reviewer notes and positive steps the peer reviewer performs, the more the peer reviewer can place reliance on the firm's internal inspection and reduce the scope of his or her direct efforts.

Other factors to consider regarding procedures and results of an internal inspection performed in the year of the peer review include:

- **Robustness of the firm's internal inspection.** The internal inspection should not only be comprehensive, objective, detailed, and well-conducted, but reflect a

continued proactive willingness by the firm's management and the internal inspectors to use a lower threshold than is required under the applicable quality control and other professional standards to uncover deficiencies and weaknesses prior to identification by other parties. Other factors that result in a more robust internal inspection include expanding the use of topical specialists and increasing the number of engagements reviewed or partners covered, and the various sources of oversight over the internal inspection process, including the AICPA, as part of its oversight of peer reviews. Furthermore, it is expected that the firm maintain this focus on robustness despite other environmental changes.

- **Scope.** An internal inspection's scope includes all clients. Assuming that the firm's system of quality control does not distinguish SEC from non-SEC engagements in any significant way, the peer reviewer will consider the internal inspection results for the firm's entire practice, even though SEC engagements have been carved out of the scope of an AICPA peer review to determine if anything arising in connection with the inspection of SEC engagements could apply to non-SEC engagements or the overall system of quality control. In addition, the internal inspection's scope should also consider industries that have a significant public interest. Industries that have a significant public interest are those that benefit the general welfare of the public, such as benefit plans under ERISA, engagements performed under GAS (the Yellow Book), the Federal Deposit Insurance Corporation Improvement Act, and so on. The peer reviewer should consider the internal inspection's focus on the public interest industry engagements that it performs when determining whether reliance can be placed with respect to those industries.

- **Potential biases of internal inspectors.** An internal inspector is reviewing work performed by his coworkers and staff, and sometimes himself. Generally, he has been exposed to the same training, experience, and perspective to which others in his firm have been exposed. There is also the risk that the inspector is protective of the firm's reputation. At the same time, internal inspectors are much more familiar with their firm's policies and protocols and may be in a better position to identify departures from those policies and protocols than a peer reviewer. These influences and their potential impact on the internal inspection work product should be considered.

- **Extent of the peer reviewer's involvement in the internal inspection.** Factors to consider include the following:

  — Timely involvement in internal inspection planning, such as inclusion in discussions or meetings, and the peer reviewer's approval of internal inspectors 'qualifications, the internal inspection's risk assessment, scopes, risk-based approach, and office or engagement selections.

  — Coordination of peer review planning with internal inspection planning.

— An in-depth understanding of the firm's internal inspection process, including an assessment of its design and effectiveness.

— Contemporaneous testing of the firm's internal inspection procedures (commonly called "piggyback reviews"). A range of between 5 and 10% of engagement reviews or items within a functional area performed by the firm should be tested by the peer reviewer. However, the peer reviewer should also consider that the extent of piggyback testing should be commensurate with the extent of direct testing to be performed by the peer reviewer. Thus, the less piggyback testing, the more direct testing, and vice versa. Testing should be performed either to the same extent that the internal inspectors test or to the extent a peer reviewer would typically test. The testing should include a review of financial statements, working papers, and the engagement checklist being used by the internal inspector, as well as participation by the review team in discussions, meetings, or both between the internal inspector and the engagement partner or manager and related follow-up procedures. Although testing of internal inspection procedures can be performed after the internal inspection procedures are completed, this type of testing will not provide the peer reviewer with the same level of understanding and insight over the internal inspection process as do contemporaneous piggyback reviews. After the piggybacks are performed, the peer reviewer should evaluate the effectiveness of the internal inspection and reassess whether originally planned peer review scopes are adequate and reasonable.

— Assessment of how the internal inspectors resolve open matters and deal with potential issues detected in their reviews.

— Consideration of the scopes and selections of the internal inspectors and the use of peer review to balance out the coverage; the review team also should make preliminary determinations of peer review scope based on interim results of internal inspection procedures and subsequently reevaluate their appropriateness when the internal inspection is complete.

— Assessment of how closely the findings of peer review and internal inspection correlate, evaluated from the perspective of the peer review's scope.

Scope of Procedures Directly Performed by the Peer Reviewers

The Standards do not suggest minimum or maximum percentages of the reviewed firm's accounting and auditing hours that should be reviewed. Determining the appropriate coverage for a review is a matter of judgment, but, nevertheless, depending on the number of positive factors and positive procedures performed by the peer reviewer, as previously discussed, a peer reviewer may be able to significantly reduce the scope of the

procedures he or she directly performed in the past. A significant reduction would be permitted only when the extent of the peer reviewer's involvement with the firm's internal inspection is so timely and significant that the peer review and internal inspection can truly be viewed as an integrated activity resulting in a reallocation of effort and resources among and between the peer reviewer and the firm in such a way that the overall scope and the effort involved are not diminished but, if anything, are enhanced. The resulting peer review should remain as rigorous as a peer review where there is no consideration of internal inspections or other inputs.

If, because of the effectiveness of the reviewed firm's current year's internal inspection procedures, the review team intends to reduce the scope of the peer review, the review team should consider the reviewed firm's basis for selecting offices and engagements for internal inspection procedures when determining the offices and engagements the review team will review. The selection of offices and engagements for the peer review should complement the selection for the current year's internal inspection procedures. For example, if the reviewed firm's selection of offices and engagements for internal inspection procedures is weighted more toward obtaining a reasonable cross section of its accounting and auditing practice (for example, coverage of all partners and offices every three years), then the review team should place greater weight on selecting offices and engagements with higher combined assessed levels of inherent and control risk.

Consultation With AICPA Staff and Peer Review Committee Panelists

Peer reviewers are required to inform AICPA Technical Staff (Staff) during peer review planning if, after considering this guidance, they plan on significantly reducing the scope of the procedures they will be performing. Depending on the circumstances, Staff may recommend that a panel from the board or its Task Forces review a firm's internal inspection or peer review planning in advance. In addition, a firm, or peer reviewer may request that the administering entity review the internal inspection or peer review planning in advance.

Documentation

Existing guidance requiring a peer reviewer to document the work performed and the findings and conclusions of a peer review will apply to any procedures performed to evaluate or test internal inspection or the impact of regulatory oversight, including involvement in internal inspection planning procedures and piggyback procedures. The peer reviewer should include a discussion of their procedures in or as an attachment to the Summary Review Memorandum.

Practical Examples in Implementing This Guidance

The following brief examples illustrate how the preceding guidance can be implemented. Of course, these examples cannot address all the different factors a peer reviewer could

consider, and thus the peer reviewer will need to use judgment in determining whether and to what extent he or she could reduce or modify scope.

Example #1: A firm has 800 employees, 10 offices, and a strong centralized quality control department; operates by industry segment; and has pre-issuance reviews and annual internal inspections. It is registered with the PCAOB, undergoes annual PCAOB inspection, and has one system of quality control for both SEC and non-SEC engagements. Based on various factors, the peer reviewers have assessed inherent and control risk as low. Prior peer reviews have been *pass* reports. Internal inspection appears robust, and, beginning last year, the firm lowered the bar for "no" responses on checklists used for internal inspections. The peer reviewers were integrally involved in the internal inspection, approved the planning, and attended several office exit conferences. In addition, they performed piggybacks on 5% of the firm's internal inspection procedures and those procedures confirmed other internal inspection results. The PCAOB was involved in the current year's internal inspection planning, and results of the prior year's PCAOB inspection mirrored prior internal inspection results. Results from a DOL audit that covered the peer review year raised an issue that was also highlighted during the current year's internal inspection. *The peer reviewers could consider maximum reliance on the internal inspection process and thus consider a reduction in scope or procedures.*

Example #2: A firm has 300 employees and five offices. The firm has undergone several mergers in the past two years. Engagements undergo pre-issuance review, and each office performs its own internal inspection that is then sent to the main office. The firm engaged new peer reviewers and asked them to implement the guidance contained in this document with the intent of reducing scope and procedures and thus costs. The peer reviewers participated in planning meetings and performed a number of piggybacks. However, the peer reviewers disagree with some of the judgment decisions made by the internal inspectors and believe that the results from the offices are not being consolidated adequately. They are concerned that the integration of the firms has not been successful. The firm is registered with the PCAOB and underwent an inspection in the past year. However, the report is not yet public, and the firm is unable or unwilling to communicate the results or its experiences with the peer reviewers. *The peer reviewer should not place significant reliance on internal inspection to reduce scope or procedures.*

Example #3: A firm has 60 employees and two offices. It performs pre-issuance reviews and annual internal inspections. The peer reviewers have assessed inherent and control risk as moderate. Prior peer reviews have been *pass* reports with a few FFCs. The firm has a very experienced and highly-regarded quality control director who is assisted by several of the firm's more technical partners each year in performing the internal inspection. They approach the internal inspection seriously. The peer reviewers were integrally involved in the internal inspection, approved the planning, and attended several office exit conferences. In addition, they performed piggybacks on 7% of the firm's internal inspection procedures, and those procedures confirmed other internal inspection results, even though they revealed several issues that might lead to findings. The firm is registered with the PCAOB and underwent an inspection in the prior year. The quality

control director shared the PCAOB's matter sheets with the peer reviewers. The PCAOB had noted that staff was not adequately documenting SAS 99 considerations on the SEC engagements. The internal inspectors paid particular attention to this matter and agreed that it was a problem for one of the offices. *The peer reviewers could consider moderate reliance on the internal inspection process and thus consider some reduction in scope or procedures.*

Example #4: A firm has 20 employees and 1 office. It has no SEC engagements and is not registered with the PCAOB. Its last peer review was *pass* with no findings. The firm performs pre-issuance reviews and annual internal inspections. The partner that performs the internal inspection is also the pre-issuance reviewer or engagement partner on many of the firm's audit engagements. Its annual internal inspection is performed in the spring, but, due to scheduling conflicts, its peer reviewer, who comes from out of state, is only available in the fall. The two peer reviewers typically review four audits and four reviews or compilations, within a two or three day timeframe. *Cost-benefit and other considerations would most likely lead the firm and the peer reviewers to conclude that there should be no reliance on the internal inspection to reduce scope or procedures.*

Quality Control Materials Reviews

Illustrative Guidance to Interpretation No. 176-1

Interpretation No. 176-1 of the standards discusses that Quality Control Materials (QCM) should include a sufficient level of instructions and explanatory guidance to be considered reliable aids. Interpretation No. 176-1 indicates that there is more guidance in the following table, which illustrates the extent of guidance that would customarily be present for QCM to constitute reliable aids for the topics listed. This table is for illustrative purposes only, the steps listed are not intended to be all inclusive, nor are they intended to describe the minimal guidance required to constitute reliable aids.

Topic	Sufficient Explanatory Guidance	Insufficient Guidance
Materiality	Guidance which interprets the provisions of AU-C section 320, *Materiality in Planning and Performing an Audit*, including considerations at the financial statement level, user considerations, industry considerations, the concept of tolerable misstatement, and	Ex: An audit program step notes the following — <u>Determine and document audit materiality.</u> There is no further guidance provided or references to the professional standards on this topic in the materials.

Topic	Sufficient Explanatory Guidance	Insufficient Guidance
	reconsideration of planned materiality level as the audit progresses.	The preceding example is insufficient as it lacks discussion of the considerations referenced in the middle column (for example, no step with considerations related to the selecting the appropriate basis for calculating materiality, no steps to determine planning materiality, tolerable misstatement, or the posting threshold, and so on).
Confirmation of Receivables	Guidance which interprets the provisions of AU-C section 505, *External Confirmations*, including definition of the confirmation process, the generally accepted auditing standards presumption that confirmation of accounts receivable is required and conditions in which the presumption may be overcome, the assertions addressed by confirmations, design of the confirmation request (negative vs. positive) and the conditions under which negative confirmations may be used, maintaining control of confirmations, nature and extent of alternative procedures, and evaluation of results of the confirmation process. In addition, guidance on audit sampling in AU-C section 530, *Audit Sampling* (that is, application of audit procedures to less than	Ex: An audit program step notes the following — <u>Confirm Receivable Balances</u> • Select receivables for confirmation • Mail receivables and maintain control. Mail second requests as deemed necessary • Agree balances on returned receivables to the G/L • Document results * If confirmations are not sent, document the reasons for this decision. There is no further guidance provided or references to the professional standards on this topic in the materials. The preceding example is insufficient as it lacks discussion of the considerations referenced in

Topic	Sufficient Explanatory Guidance	Insufficient Guidance
	100% of items in the account balance), as well as guidance on audit documentation (AU-C section 230, *Audit Documentation*), would customarily be included. Audit program steps, identified by relevant assertions would also be customarily included.	the middle column for each step of the process (for example, "Select receivables for confirmation" as an audit step, but no additional discussion of planning considerations — negative vs. positive confirmations, timing, the assertions that are addressed, the sampling methodology, and so on).
Management Representation Letters	Guidance which interprets the provisions of AU-C section 580, *Written Representations*, related to the requirement to obtain representation from management, coverage of all periods, guidance as to tailoring requirements, and guidance as to dating the letter. Illustrative examples of representation letters would also be customarily included.	Ex: An audit program step notes the following — <u>Obtain a letter of Management's representations.</u> There is no further guidance provided or references to the professional standards on this topic in the materials. The preceding example is insufficient as it lacks discussion of the considerations referenced in the middle column (for example, with respect to dating the representation letter, considerations related to the dating of the report, considerations if report issuance is substantially delayed, and so on).
Date of Auditor's Report	Guidance which interprets the provisions of AU-C section 700A, *Forming an Opinion and Reporting on Financial Statements*, including the requirement that the auditor report should not be dated earlier than the date on which the auditor has obtained sufficient appropriate audit	Ex: An audit program step notes the following — <u>Determine the appropriate date of the Auditor's Report.</u> There is no further guidance provided or references to the professional standards on this topic in the materials.

Topic	Sufficient Explanatory Guidance	Insufficient Guidance
	evidence to support the opinion.	The preceding example is insufficient as it lacks discussion of the considerations referenced in the middle column (for example, impact of subsequent event procedures, review of the engagement file, and so on).

As illustrated, QCM limited to audit program steps without explanatory guidance or specific reference to applicable professional standards would be considered insufficient, and do not constitute reliable aids. This guidance should be considered in conjunction with the guidance at Interpretation No. 176-1.

Evaluating a Firm's QCM

The following are several examples for evaluating a firm's QCM using the guidance in Interpretations 42-2 and 42-3. For each example, the firm under review has provided its Quality Control Policies and Procedures Documentation Questionnaire (QCQ) responses to the team captain during planning for its peer review.

Example 1

The QCQ responses related to QCM indicate that the firm uses QCM guides from Smith & Co. for its audits of a construction contractor and several small retail stores, as well as reviews and compilations. The firm indicates in its QCQ that it purchased the guides right after and as a result of its last peer review. The firm also indicates that the managing partner has determined that the QCM are reliable and suitable for the firm. The firm provides a copy of the QCM report for the Smith & Co. guide for audits of nonpublic companies and the Smith & Co. guide for reviews and compilations.

The team captain recognizes Smith & Co. as a popular and often used QCM provider. However, the team captain notices that the QCM review reports are from several years ago and knows there are more recent ones available. He also notices that there is no QCM review report for the construction contractor, even though he knows the industry is specialized and that the provider offers a guide specific to the industry.

Upon inquiry, the team captain learns that the firm has not purchased updated guides since the firm's last peer review. Further, the firm did not purchase QCM for its construction contractor when the engagement was obtained a year ago.

Based on this information, the team captain assesses the firm's quality control policies and procedures for adopting, updating, and modifying its QCM to be insufficient. Further, although the QCM may have been reliable for engagements performed several years ago, based on the number of changes in professional standards that have occurred since the firm originally purchased the QCM, the team captain deems the particular versions used by the firm to be unreliable for their peer review year. The team captain concludes that the QCM might have been suitable if the firm had updated them more often and used the construction contractor guide for its new engagement during the peer review year.

Example 2

The QCQ responses related to QCM indicate that the firm uses QCM guides from Jones & Co. for its audits of a manufacturer, a restaurant, and several employee benefit plans. The firm indicates in its QCQ that the firm's accounting and auditing (A&A) partner carefully assesses what QCM guides the firm will need on an engagement by engagement basis. During the A&A partner's volunteer work with the firm's state society, he has had the opportunity to consult with many others on what QCM are available, determining that QCM guides from Jones & Co. were the most reliable and suitable for his firm. The firm indicates that its QCM undergo a QCM Review, but does not provide any report copies. The firm also indicates that it has developed its own risk assessment (RA) practice aids for use on the employee benefit plans (EBP).

Going to the AICPA website, the team captain notes that the provider's restaurant guide is not included in the scope of any of the provider's last few QCM reviews. He knows that not all QCM published by a provider may be included in the scope of a QCM review. The team captain consults guidance at paragraphs .167–.176 to assess the reliability of both the restaurant guide and the risk assessment practice aid for use on the EBPs.

Based on his procedures, he concludes that the restaurant guide appears reliable. However, he has concerns about the RA practice aids for EBPs and whether they will assist the firm in complying with the applicable professional standards. The firm notes in its QCQ that the RA practice aids were developed by the A&A partner, who has a strong background in EBPs and is on the state society's committee for audits of EBPs. The team captain notes that the RA practice aid is highly summarized and assumes a strong understanding of the industry and the underlying EBP specific professional standards by an experienced professional. However, the first year staff completes the RA practice aid for the EPB engagements. The team captain notes that he will consider this further when he looks at the engagements selected for review and how the aids were implemented, including the level of detailed review performed by the A&A partner.

Except for the RA practice aids for EBPs, the team captain concludes that the firm's policies and procedures for adopting, updating, and modifying its QCM are appropriate and that the QCM are reliable and suitable.

Example 3

The QCQ responses related to QCM indicate that the firm uses a broker dealer QCM guide from Brown & Co. for its new broker dealer audit, which will supplement its otherwise predominantly tax-oriented practice. The firm indicates in its QCQ that it selected Brown & Co.'s QCM because they are short and noncomplex, making the firm's work more efficient. The firm provides copies of Brown & Co.'s QCM Review report.

The team captain is not familiar with Brown & Co. and thus, although the QCM guide has undergone a QCM review, she reviews it. She notes that it consists of only practice aids (no guidance or letter or correspondence templates) with explanatory guidance referring to the professional standards. The instructions to the QCM specifically indicate that they are intended for experienced professionals and are not to be used for training purposes. She knows the broker dealer industry, and audits overall are new for the firm. She also knows that although the practitioner has taken some audit training, no broker dealer training was taken. The team captain is concerned that the firm would need to perform significant consultation with professional standards and the broker dealer accounting and audit guide in order to satisfactorily perform the engagement in accordance with applicable professional standards. She is also concerned that the firm does not have any QCM to assist the firm with reporting or correspondence requirements.

The team captain concludes that although the QCM underwent a QCM review, and it was deemed reliable, it is not suitable for the firm, and thus the firm's policies and procedures for adopting, updating, and modifying the QCM are weak.

Example 4

The QCQ responses related to QCM indicate that the firm uses QCM guides from Wise & Co. for all of its engagements, including its audits of not-for-profits, healthcare, CIRA, and employee benefit plans, plus reviews, compilations, and several agreed upon procedures. The firm's practice has been stable for the last 10 years.

The firm provides a copy of the QCM review report. The report's attachment lists the QCM that were covered by the review's scope. The team captain notes that the guides for all of the specialized industries that the firm practices in were included in the QCM review's scope. She also notices that the report covers the specific versions used by the firm during the peer review year. Lastly, she notices

that there are no scope exclusions noted in the QCM review report. Based on her procedures, she concludes that the QCM appear reliable.

The firm indicates in its QCQ that it has successfully used the QCM for over 10 years. The firm updates its QCM annually to ensure the most up-to-date guidance is included. Upon inquiry, the team captain learns that the firm purchases the full QCM package from Wise & Co., which includes practice aids (including audit programs and a risk assessment toolkit), letter templates, and sample completed aids and templates. The team captain knows that this provider's QCM integrates the verbiage of the standards into the practice aids to ease their use. The firm acknowledges that although staff may take more time completing the aids because they are lengthy, the firm believes they are providing staff with the tools to more easily research and determine if the engagement is complying with professional standards. Occasionally the firm determines it necessary to perform the enhanced procedures in additional to the general procedures in the audit programs, depending on the circumstances. Otherwise, the firm has not needed to make any modifications to the QCM.

Based on all of this information, the team captain assesses the firm's quality control policies and procedures for adopting, updating, and modifying its QCM to be sufficient and the QCM to be suitable for the firm.

For each of the preceding examples, the team captain considers the weaknesses in the system of quality control, if any, when assessing other aspects of the firm's system of quality control. This includes the firm's compliance with quality control standards established by the AICPA and how the firm's policies and procedures identify and mitigate the risk of material noncompliance with applicable professional standards. Any weaknesses are considered when the team captain prepares his or her risk assessment, determines scope, performs his or her functional testing, concludes on the peer review, and considers the systemic causes for matters, findings, deficiencies, and significant deficiencies.

Tone at the Top

What is Tone at the Top?

The AICPA Statements on Quality Control Standards (SQCS) No. 8 requires firms to establish and maintain a system of quality control to provide it with reasonable assurance that the firm and its personnel will comply with professional standards and applicable legal and regulatory requirements and also that reports issued by the firm are appropriate in the circumstances. One of the elements necessary to achieve such a system is leadership responsibilities for quality within the firm ("tone at the top"). 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.

Indicators of a Tone at the Top Systemic Cause

Indicators of a tone at the top systemic cause include but are not limited to

- firm leadership does not assume ultimate responsibility for the firm's system of quality control.
- the person(s) assigned operational responsibility for the firm's system of quality control by the firm's leadership does not have sufficient and appropriate experience to identify and understand quality control issues and develop appropriate policies and procedure or have the ability or authority to implement those policies and procedures.
- there are not 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.
- the firm has not established 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.
- the firm has not assigned management responsibilities so that commercial considerations do not override the quality of the work performed.
- the firm does not provide sufficient and appropriate resources for the development, documentation and support of its quality control policies and procedures.
- with respect to internal inspections, peer review, and other third party inspections, the firm's policies and procedures do not ensure the firm will consider the results of those inspections, identify the systemic cause of issues identified, appropriate remediation of the firm's system of quality control, or monitoring of compliance with revised policies and procedures.
- deficiencies identified during the peer review can be attributed to multiple quality control elements.
- pervasive, firm-wide, noncompliance with applicable professional standards was identified during the peer review.

Evaluate Firm Response to MFCs, FFCs, and Deficiencies

In addition to the indicators described above, the firm's response to MFCs, FFCs, and deficiencies should be evaluated to determine the true systemic cause. If the wrong

systemic cause is identified, the firm may not know what part(s) of its system need correction. Reviewers should use professional skepticism and ask probing questions to identify the true systemic cause. At the MFC, FFC, and deficiency level, a firm response of *it was an oversight* or *staff missed it* are not acceptable without further investigation. Reviewers should ask additional questions to understand why it was an oversight or why did staff not follow practice aids and why wasn't it caught before the report was issued. The firm's response to the MFC, FFC, or deficiency should be appropriate to address the systemic cause, including but not limited to the indicators listed above.

Recalled Peer Review Report- Replacement Review Considerations

Reviewers should consider whether a tone at the top deficiency is present when acceptance of a firm's peer review is recalled. The circumstances that led to the need for a recalled peer review should be considered as well the systemic cause. Using the omission of must select engagements from peer review as an example, reviewers should

- consider whether the firm identified and reported the omission to its administering entity or whether the need for recall was identified by another party.
- consider whether population completeness is an isolated incident or whether there are overarching problems with the firm's system of quality control (or any of the other indicators described above).
- conclude based on systemic causes identified and not based on the percentage of the firm's practice that was omitted.

Reporting Considerations for Tone at the Top

Tone at the top weaknesses should be considered and evaluated to determine if it should be a significant deficiency. Often times, it results in a significant deficiency as a tone at the top weakness suggests that a firm's system of quality control is not suitably designed to provide a firm with reasonable assurance of performing or reporting in conformity with professional standards in all material respects, including scenarios where the peer review did not result in any nonconforming engagements. The relative importance of design matters noted in the reviewed firm's quality control policies and procedures, individually and in the aggregate, need to be evaluated in the context of the firm's size, organizational structure, and the nature of its practice. The reviewer should consider whether the weakness should be a finding, deficiency, or significant deficiency.

Timeline of Peer Review Process and Significant Events

See below for a timeline of the approximate timing of significant events occurring during the peer review process. The timeline is intended to highlight that the peer review process requires an investment of time by both the firm and the reviewer. A brief summary of the

guidance for each of the significant events is below. For the complete guidance for each of these events, refer to the Standards and Interpretations.

Enrollment in the Peer Review Program

By the report date of the firm's first reviewable engagement, a firm should complete and submit the peer review enrollment materials to the administering entity. Once enrolled, a due date for the firm's initial review is assigned, generally 18 months from the report date of the first engagement causing the firm to be enrolled in the program.

Scheduling the Review

Approximately six to nine months before a firm's review due date, the administering entity will send a firm scheduling form to complete and submit in order for the review to be scheduled. To provide sufficient time to the firm, the peer review should ordinarily be conducted within three to five months after the end of the year to be reviewed. Background information from the completed scheduling forms, such as composition of practice and selected peer reviewer, is entered into an AICPA database accessible by administering entities to determine whether the reviewer is qualified. The administering entity is responsible for approving a reviewer and once approved, the peer review is scheduled, usually within two months after the scheduling forms are received. Approval must be obtained prior to commencement of the review.

Performing the Review

When all requested documents are received by the reviewer from the reviewed firm, they will be evaluated to determine the appropriate report. A closing meeting will be held in which the reviewer will provide preliminary results of the peer review to include, but not be limited to, matters, findings, deficiencies, and significant deficiencies. The closing meeting may need to occur at least 30 days prior to the firm's due date to allow sufficient time for the firm to determine appropriate remediation with respect to matters identified in the review and for the team captain/review captain to assess the impact of the firm's responses on the peer review, if any.

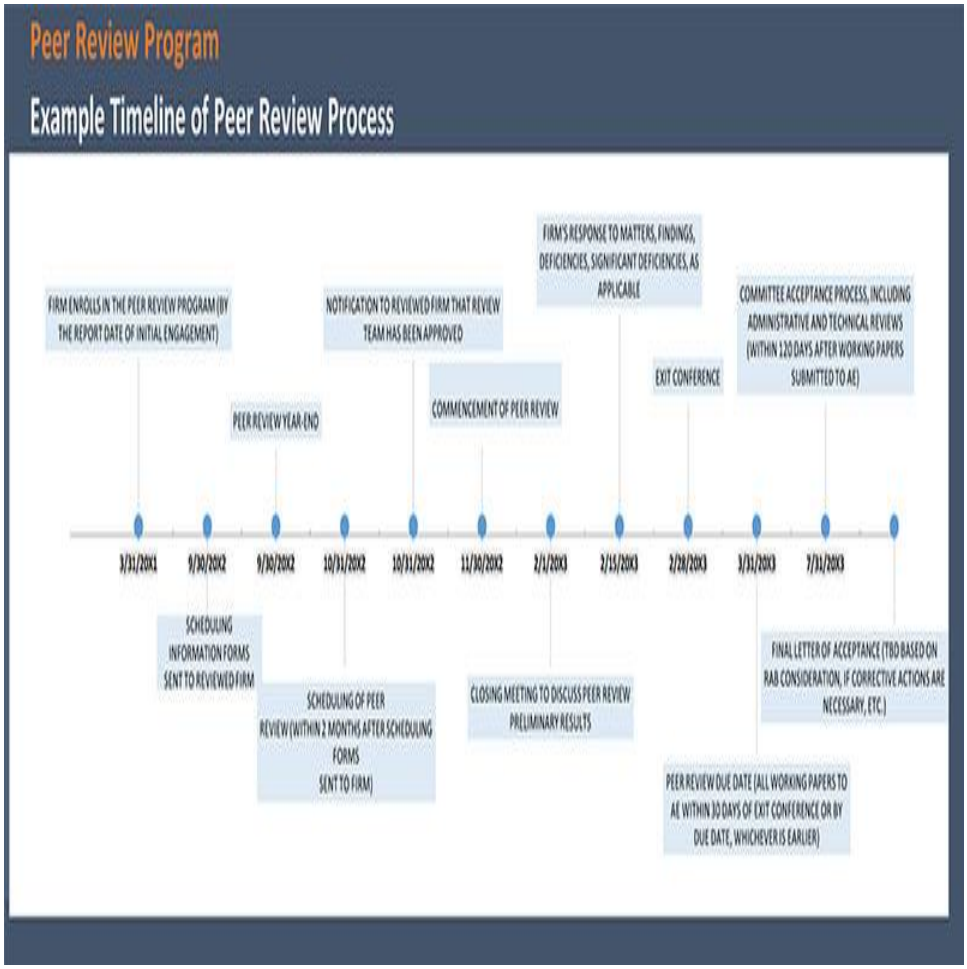
The reviewer will then schedule an exit conference prior to, but no later than, the peer review due date. During the exit conference, the final peer review results will be discussed as well as the process following the exit conference, including RAB evaluation and acceptance. The peer reviewer is responsible for submitting the peer review working papers to the administering entity and for issuing the report to the firm within 30 days of the exit conference or by the firm's peer review due date, whichever is earlier. Depending upon the results of the review, for example when there were no matters noted that require follow up by the firm, the closing meeting and exit conference may be the same date.

Administrative and Technical Reviews

Once the reviewer has completed the review and all materials have been submitted to the administering entity, the working papers will go through an administrative and technical review. The administrative review ensures all required documents from the reviewer are received and complete. During the technical review, the working papers submitted by the reviewer are evaluated to determine whether the review has been conducted in accordance with the Standards and whether the firm has responded to any matters, findings, deficiencies or significant deficiencies in an appropriate manner.

Review Evaluation, Acceptance, and Completion

Upon completion of the technical review, reviews are presented for consideration of acceptance at the RAB meeting with attention given to team captain/review captain and technical reviewer recommendations. Peer reviews are presented ordinarily within 120 days after working papers are received by the administering entity. The RAB reviews the report and applicable supporting documentation and determines if the review can be accepted or if additional conditions must be met. If no corrective actions are necessary, the completion date of the review is the acceptance date. If corrective actions are necessary, the review is considered completed when the firm has performed the corrective actions to the RAB's satisfaction.

Example Timeline of Peer Review Process

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