# PRP Section 1000

## AICPA STANDARDS FOR PERFORMING AND REPORTING ON PEER REVIEWS

**Notice to Readers**

In order to be admitted to or retain their membership in the AICPA, members of the AICPA who are engaged in the practice of public accounting in the United States or its territories are required to be practicing as partners or employees of firms enrolled in an approved practice-monitoring program or, if practicing in firms not eligible to enroll, are themselves enrolled in such a program if the services performed by such a firm or individual are within the scope of the AICPA's practice-monitoring standards and the firm or individual issues reports purporting to be in accordance with AICPA professional standards.

Firms have peer reviews because of the public interest in the quality of the accounting, auditing, and attestation services provided by public accounting firms. In addition, firms indicate that peer review contributes to the quality and effectiveness of their practices. Furthermore, most state boards of accountancy require its licensees to undergo peer review, which they may also call compliance assurance, to practice in their state. Other regulators require peer review in order to perform engagements and to issue reports under their standards.

A firm (or individual) enrolled in the AICPA Peer Review Program is deemed to be enrolled in an approved practice-monitoring program. See BL sections 230, *2.3 Requirements for Retention of Membership*, 220, *2.2 Requirements for Admission to Membership*, and 760, *7.6 Publication of Disciplinary Action* (AICPA, *Professional Standards*); "Form of Organization and Name Rule" and its interpretations (AICPA, *Professional Standards*, ET sec. 1.800.001); and the implementing council resolutions under those sections.

These standards are applicable to firms (and individuals) enrolled in the program and to individuals and firms who perform and report on such peer reviews, to entities approved to administer the peer reviews, and to associations of CPA firms authorized by the AICPA Peer Review Board (board) to assist its members in forming review teams. These standards are not intended for peer reviews of organizations that are not public accounting firms.

Users of these standards should be knowledgeable about the standards and their interpretations and effective dates, as well as guidance issued by the board that might affect the application of these standards. Those subject to the standards should be prepared to justify departures from these standards, and it is expected that departures will be rare.

These standards are effective for peer reviews commencing on or after January 1, 2009. Early implementation of these standards is not permitted.

## Overview

**Summary of the Nature, Objectives, Scope, Limitations of, and Procedures Performed in System and Engagement Reviews (as Referred to in a Peer Review Report)**

**.01** The purpose of this document is to provide standards for administering, planning, performing, reporting on and the acceptance of peer reviews of CPA firms (and individuals) enrolled in the AICPA Peer Review Program (see interpretations). Those processes collectively are also called *practice monitoring* because it is the monitoring of a CPA firm's accounting and auditing practice.

**.02** The goal of practice monitoring, and the program itself, is to promote quality in the accounting and auditing services provided by the CPA firms (and individuals) subject to these standards. This goal serves the public interest and enhances the significance of AICPA membership.

**.03** Firms (and individuals) (see interpretations) enrolled in the program are required to have a peer review, once every three years, of their accounting and auditing practice related to non-SEC issuers covering a one-year period. The peer review is conducted by an independent evaluator known as a peer reviewer. The AICPA oversees the program, and the review is administered by an entity approved by the AICPA to perform that role.

**.04** There are two types of peer reviews: System Reviews and Engagement Reviews. System Reviews focus on a firm's system of quality control, and Engagement Reviews focus on work performed on selected engagements. A further description of these peer reviews as well as a summary of the nature, objectives, scope, limitations of, and procedures performed in them is included in appendix A, "Summary of the Nature, Objectives, Scope, Limitations of, and Procedures Performed in System and Engagement Reviews and Quality Control Materials Reviews (as Referred to in a Peer Review Report)".

**Introduction and Scope**

**.05** Firms (and individuals) (see interpretations) enrolled in the program have the responsibility to:

*a.* Design and comply with a system of quality control for its accounting and auditing practice that provides the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Statement on Quality Control Standards (SQCS) No. 8, *A Firm's System of Quality Control (Redrafted)* (AICPA, *Professional Standards*, QC sec. 10), requires every CPA firm, regardless of its size, to have a system of quality control for its accounting and auditing practice.

*b.* Perform accounting and auditing engagements in accordance with applicable professional standards using competent personnel [fn 1] (partners [fn 2] and staff [fn 3]).

---

[fn 1] Personnel are defined per Statement on Quality Control Standards (SQCS) as partners and staff.

[fn 2] Partners are defined per SQCS as any individual with authority to bind the firm with respect to the performance of a professional services engagement.

[fn 3] Staff are defined per SQCS as professionals, other than partners, including any specialists that the firm employs.

*c.* Have independent peer reviews of their accounting and auditing practices (see interpretations). All firms that an AICPA member is associated with should undergo a peer review if the services performed and reports issued by the firm require a peer review.

*d.* Engage a peer reviewer to perform the peer review in accordance with these standards, in a timely manner.

*e.* Take such measures, if any, as may be necessary to satisfy its obligations concerning client confidentiality any time state statutes or ethics rules promulgated by state boards of accountancy do not clearly provide an exemption from confidentiality requirements when peer reviews are undertaken.

*f.* Provide written representations to describe matters significant to the peer review (see appendix B "Considerations and Illustrations of Firm Representations").

*g.* Understand the AICPA Peer Review Board's guidance on resignations from the program (see interpretations).

*h.* Cooperate with the peer reviewer, administering entity, and the AICPA Peer Review Board (board) in all matters related to the peer review, that could impact the firm's enrollment in the program, including arranging, scheduling, and completing the review and taking remedial, corrective actions and implementing other plans as needed (see interpretations).

**.06** An *accounting and auditing practice* for the purposes of these standards is defined as all engagements performed under Statements on Auditing Standards (SASs); Statements on Standards for Accounting and Review Services (SSARS); [fn 4] Statements on Standards for Attestation Engagements (SSAEs); *Government Auditing Standards* (the Yellow Book) issued by the U.S. Government Accountability Office; and engagements performed under PCAOB standards (see interpretations). Engagements covered in the scope of the program are those included in the firm's accounting and auditing practice that are not subject to PCAOB permanent inspection (see interpretations).

**.07** The objectives of the program are achieved through the performance of peer reviews involving procedures tailored to the size of the firm and the nature of its practice. Firms that perform engagements under the SASs or *Government Auditing Standards*, examinations under the SSAEs, or engagements under PCAOB standards, as their highest level of service have peer reviews called *System Reviews*. A System Review includes determining whether the firm's system of quality control for its accounting and auditing practice is designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards, including SQCS No. 8, in all material respects. Firms that only perform services under SSARS or services under the SSAEs not included in System Reviews are eligible to have peer reviews called *Engagement Reviews*, however firms that only perform preparation engagements (with or without disclaimer reports) under SSARS are not required to enroll in the program (see interpretations). These standards are not intended for and exclude the review of the firm's accounting and auditing practice applicable to engagements subject to PCAOB permanent

[fn 4] Statements on Standards for Accounting and Review Services that provide an exemption from those standards in certain situations are likewise excluded from this definition of an accounting and auditing practice for peer review purposes (see interpretations).

inspection (see interpretations). Firms that do not provide any of the services listed in paragraph .06 are not peer reviewed (see interpretations).

**.08** The majority of the procedures in a System Review should be performed at the reviewed firm's office (see interpretations). Engagement Reviews are normally performed at a location other than the reviewed firm's office.

**.09** The program is based on the principle that a systematic monitoring and educational process is the most effective way to attain high quality performance throughout the profession. Thus, it depends on mutual trust and cooperation. On System Reviews, the reviewed firm is expected to take appropriate actions in response to findings, deficiencies, and significant deficiencies identified with their system of quality control or their compliance with the system, or both. On Engagement Reviews, the reviewed firm is expected to take appropriate actions in response to findings, deficiencies, and significant deficiencies identified in engagements. These actions will be positive and remedial. Disciplinary actions (including those that can result in the termination of a firm's enrollment in the program and the subsequent loss of membership in the AICPA and some state CPA societies by its partners [fn 5] and employees) will be taken only for a failure to cooperate, failure to correct inadequacies, or when a firm is found to be so seriously deficient in its performance that education and remedial, corrective actions are not adequate.

**.10** Compliance with the positive enforcement program of a state board of accountancy does not constitute compliance with the AICPA's peer review requirements.

## General Considerations

### Administrative Requirements

**.11** All peer reviews intended to meet the requirements of the program should be carried out in conformity with these standards under the supervision of a state CPA society, group of state CPA societies, the AICPA Peer Review Board's National Peer Review Committee (National PRC) (see interpretations), or other entity (hereinafter, administering entity) approved by the board to administer peer reviews.

**.12** Peer reviews, including the reviewed firm and peer reviewers, are subject to oversight by the administering entity. In addition, peer reviews and administering entities are subject to oversight by the board and other bodies agreed upon by the board or the administering entity. The objectives of oversight are to ensure compliance with the standards and consistency in implementation. Reviewed firms, peer reviewers, and administering entities are expected to cooperate during the oversight process.

### Timing of Peer Reviews

**.13** A firm's due date for its initial peer review is ordinarily 18 months from the date it enrolled in the program or should have enrolled, whichever date is earlier (see interpretations).

---

[fn 5] A partner is a proprietor, shareholder, equity or non-equity partner, or any individual who assumes the risks and benefits of firm ownership or who is otherwise held out by the firm to be the equivalent of any of the aforementioned. Depending on how a CPA firm is legally organized, its partner(s) could have other names, such as shareholder, member, or proprietor.

**.14** A firm does not undergo a peer review if it does not perform engagements requiring it to undergo a peer review (see paragraph .07). However, when a firm performs its first engagement requiring a peer review or its first engagement requiring it to have a System Review, the firm's next due date ordinarily will be 18 months from the year-end of that engagement (18 months from the report date if it is a financial forecast, projection or agreed upon procedures engagement) (see interpretations).

**.15** A firm's subsequent peer review ordinarily has a due date of three years and six months from the year-end of the previous peer review.

**.16** The due date for a peer review is the date by which the peer review report, and if applicable, letter of response, and the peer reviewer's materials are to be submitted to the administering entity.

**.17** Peer reviews must cover a current period of one year to be mutually agreed upon by the reviewed firm and the reviewing firm. Ordinarily, the peer review should be conducted within three to five months following the end of the year to be reviewed.

**.18** A firm is expected to maintain the same year-end on subsequent peer reviews (which is three years from the previous year-end) and the same review due date (which is three years from the previous review due date) (see interpretations).

**.19** If a firm resigns from the program and subsequently reenrolls in the program, the firm's due date is the later of the due date originally assigned or 90 days after reenrolling.

**Confidentiality**

**.20** A peer review should be conducted in compliance with the confidentiality requirements set forth in the "Confidential Client Information Rule" and its interpretations (AICPA, *Professional Standards*, ET sec. 1.700.001). Except as discussed in paragraph .146, information concerning the reviewed firm or any of its clients or personnel that is obtained as a consequence of the review is confidential. Such information should not be disclosed, except as required by law, by review team members or by administering entities to anyone not involved in performing the review, or administering or carrying out the program, or used in any way not related to meeting the objectives of the program.

**Independence, Integrity, and Objectivity**

**.21** Independence in fact and in appearance should be maintained with respect to the reviewed firm by a reviewing firm, by review team members, and by any other individuals who participate in or are associated with the review (see interpretations). In addition, the review team should perform all peer review responsibilities with integrity and maintain objectivity in discharging those responsibilities.

**.22** *Independence* encompasses an impartiality that recognizes an obligation for fairness not only to the reviewed firm but also to those who may use the peer review report. The reviewing firm, the review team, and any other individuals who participate on the peer review should be free from any obligation to, or interest in, the reviewed firm or its personnel. The concepts in the "Integrity" principle (ET sec. 0.300.040), and the "Objectivity and Independence" principle (ET sec. 0.300.050) (AICPA, *Professional Standards*), should be considered in making independence judgments. *Integrity* requires the review team to be honest and candid within the constraints of the reviewed firm's confidentiality. Service and the public trust should not be subordinated to personal gain and advantage. *Objectivity* is a state of mind and a quality that lends value to a review team's services. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest.

**Due Professional Care**

**.23** Due professional care, as addressed by the "Due Care" principle (AICPA, *Professional Standards*, ET sec. 0.300.060), should be exercised in performing and reporting on the review. This imposes an obligation on all those involved in carrying out the review to fulfill assigned responsibilities in a professional manner (see interpretations).

**Peer Review Documentation and Retention Policy**

**.24** Peer review documentation should be prepared in sufficient detail to provide a clear understanding of its purpose, source, and the conclusions reached. The documentation provides evidence of the work performed and is the basis for the review of the quality of the work. It should demonstrate that the peer reviewer complied with these standards and should support the basis for the peer reviewer's conclusions. Also, the documentation should be appropriately organized to provide a clear link from the working papers to the peer review report (see interpretations).

**.25** Peer review documentation should not be retained for an extended period of time after the peer review's completion, with the exception of certain documents that are maintained until the subsequent peer review's acceptance and completion (see interpretations).

## Organizing the System or Engagement Review Team

**.26** A System Review team comprises one or more individuals, depending upon the size and nature of the reviewed firm's practice and other factors. An Engagement Review team ordinarily comprises one individual. A review team may be formed by a firm engaged by the firm under review (a firm-on-firm review) or an association of CPA firms authorized by the board to assist its members in forming review teams (an association formed review team) (see interpretations). For Engagement Reviews, review teams may also be formed by the administering entity if it chooses to appoint such teams (hereinafter, a committee-appointed review team, also known as a CART review).

**.27** A reviewing firm (including for these purposes the team captain, for an association formed review team) must determine its capability to perform a peer review. This determination includes assigning peer reviewers with appropriate levels of expertise and experience to perform the review. Before accepting a peer review engagement, the reviewing firm should obtain and consider information about the firm to be reviewed, including certain operating statistics concerning size, nature of practice, industry specializations, and levels of service.

**.28** In determining its capability to perform the review, the reviewing firm should consider the size of the firm to be reviewed in relation to its own size. A reviewing firm must recognize that the performance of a peer review may demand substantial commitments of time, especially from its supervisory accounting and auditing personnel. Therefore, a reviewing firm should consider carefully the number and availability of its supervisory personnel in determining whether it can perform a peer review of another firm.

**.29** One member of the System Review team is designated the team captain. The individual performing an Engagement Review is designated the review captain. The team captain or review captain is responsible for supervising and conducting the review, communicating the review team's findings to the reviewed firm and to the administering entity, preparing the report on the review, and ensuring that peer review documentation is complete and submitted to the administering entity on a timely basis. If applicable, the team captain, or review captain in unusual circumstances, should supervise and review the work performed by other reviewers on the review team to the extent deemed necessary under the circumstances.

**.30** A System Review team, a review captain on an Engagement Review and, in unusual circumstances any additional reviewers on an Engagement Review, ordinarily should be approved by the administering entity prior to the planning and commencement of the peer review (see interpretations).

## Qualifying for Service as a Peer Reviewer

### System and Engagement Reviewers

**.31** Performing and reporting on a peer review requires the exercise of professional judgment by peers (see paragraphs .147–.153 for a discussion of a reviewer's responsibilities when performing a peer review). Accordingly, an individual serving as a reviewer on a System or Engagement Review should at a minimum:

*a.* Be a member of the AICPA in good standing (that is, AICPA membership in active, nonsuspended status) licensed to practice as a CPA.

*b.* Be currently active in public practice at a supervisory level in the accounting or auditing function of a firm enrolled in the program (see interpretations), as a partner of the firm, or as a manager or person with equivalent supervisory responsibilities. [fn 6] To be considered currently active in the accounting or auditing function, a reviewer should be presently involved in the accounting or auditing practice of a firm supervising one or more of a firm's accounting or auditing engagements or carrying out a quality control function on a firm's accounting or auditing engagements (see interpretations). CPAs who wish to serve as reviewers should carefully consider whether their day-to-day involvement in accounting and auditing work is sufficiently comprehensive to enable them to perform a peer review with professional expertise (see interpretations).

*c.* Be associated with a firm (or all firms if associated with more than one firm) that has received a report with a peer review rating of *pass* for its most recent System or Engagement Review that was accepted timely, ordinarily within the last three years and six months (see interpretations).

*d.* Possess current knowledge of professional standards applicable to the kind of practice to be reviewed, including quality control and peer review standards. This includes recent experience in and knowledge about current rules and regulations appropriate to the level of service applicable to the industries of the engagements that the individual will be reviewing (see interpretations). [fn 7]

*e.* Have spent the last five years in the practice of public accounting in the accounting or auditing function.

---

[fn 6] A manager or person with equivalent supervisory responsibilities is a professional employee of the firm who has either a continuing responsibility for the overall planning and supervision of engagements for specified clients or authority to determine that an engagement is complete subject to final partner approval if required.

[fn 7] A reviewer should be cautious of those high-risk engagements or industries in which new standards or regulations have been issued. For example, in those cases in which new industry standards or practices have occurred in the most recent year, it may be necessary to have *current* practice experience in that industry.

*f.* Have provided the administering entity with information that accurately reflects the qualifications of the reviewer including recent industry experience, which is updated on a timely basis (see interpretations).

*g.* If the reviewer will review engagements that must be selected in a System Review under paragraph .63, possess specific additional qualifications (see interpretations).

*h.* If the reviewer is from a firm that is a provider of quality control materials (QCM) or is affiliated with a provider of quality control materials and is required to have a QCM review under these standards, be associated with a provider firm or affiliated entity that has received a QCM report with a review rating of *pass* for its most recent QCM review that was submitted timely, ordinarily within six months of the provider's year-end.

### Team Captain or Review Captain

**.32** In addition to adhering to the requirements in paragraph .31(a–f) to be a peer reviewer, a System Review team captain must be a partner. [fn 8] For an Engagement Review, the review captain is not required to be a partner. The team captain, or the review captain in limited circumstances, is required to ensure that all team members possess the necessary capabilities and competencies to perform assigned responsibilities and that team members are adequately supervised. The team captain or review captain has the ultimate responsibility for the review, including the work performed by team members (see interpretations).

**.33** Also, team captains and review captains should have completed peer review training that meets the requirements established by the board (see interpretations). For additional team captain qualification requirements, see the interpretations.

### Other Peer Reviewer or Reviewing Firm Qualification Considerations

**.34** Communications from regulatory, monitoring, or enforcement bodies relating to allegations or investigations of a peer reviewer or reviewing firm's accounting and auditing practice, and notifications of limitations or restrictions on a peer reviewer or reviewing firm to practice, may impact the peer reviewer or reviewing firm's ability to perform the peer review. The peer reviewer or reviewing firm has a responsibility to inform the administering entity of such communications or notifications (see interpretations).

**.35** If required by the nature of the reviewed firm's practice, individuals with expertise in specialized areas may assist the review team in a consulting capacity (see interpretations). For example, computer specialists, statistical sampling specialists, actuaries, or experts in continuing professional education (CPE) may participate in certain segments of the review.

## Performing System Reviews

### Objectives

[fn 8] If the peer reviewer's firm's (see paragraph .31c) most recent peer review was an Engagement Review, then the peer reviewer is not eligible to be a System Review team captain.

**.36** A System Review is intended to provide the reviewer with a reasonable basis for expressing an opinion on whether, during the year under review:

*a.* The reviewed firm's system of quality control for its accounting and auditing practice has been designed in accordance with quality control standards established by the AICPA (see SQCS No. 8).

*b.* The reviewed firm's quality control policies and procedures were being complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.

**.37** A System Review is designed to test a reasonable cross section of the firm's engagements with a focus on high-risk engagements, in addition to significant risk areas where the possibility exists of engagements not being performed or reported on in conformity with applicable professional standards in all material respects. A System Review is not designed to test every engagement or compliance with every professional standard and every detailed component of the firm's system of quality control.

**Basic Requirements**

**.38** A System Review should include, but not be limited to, the following procedures:

*a.* Planning the review, as follows:

i. Obtain the results of the prior peer review (see paragraph .39).

ii. Inquire of the firm about the areas to be addressed in the written representations (see paragraph .40).

iii. Obtain a sufficient understanding of the nature and extent of the firm's accounting and auditing practice to plan the review (see paragraphs .41–.45).

iv. Obtain a sufficient understanding of the design of the firm's system of quality control, including an understanding of the monitoring procedures performed since the prior review, to plan the review (see paragraphs .41–.45).

v. Assess peer review risk (see paragraphs .46–.52).

vi. Use the knowledge obtained from the foregoing to select the offices and the engagements to be reviewed and to determine the nature and extent of the tests to be applied in the functional areas (see paragraphs .53–.63).

*b.* Performing the review, as follows:

i. Review the firm's design and compliance with its system of quality control. The review should cover all organizational or functional levels within the firm (see paragraphs .53–.54).

ii. Review significant risk areas on selected engagements, including the relevant accounting, audit, and attestation documentation and reporting (see paragraphs .64–.65).

iii. Conclude on the review of engagements (see paragraphs .66–.67).

iv. Reassess the adequacy of the scope of the review based on the results obtained to determine whether additional procedures are necessary (see paragraph .68).

v. Determine the relative importance of matters (see paragraphs .69–.72).

vi. Prepare the Matter for Further Consideration (MFC) forms, Disposition of MFC (DMFC) forms, and any related Finding for Further Consideration (FFC) forms (see paragraphs .73–.74).

vii. Aggregate and systemically evaluate the matters (see paragraphs .75–.86).

viii. Form conclusions on the type of report to issue (see paragraphs .87–.90).

ix. Obtain the written representations from the reviewed firm (see paragraph .05(f) and appendix B).

x. Conduct an exit conference with senior members of the reviewed firm to discuss the review team's comments; matters, findings, deficiencies, and significant deficiencies identified; recommendations; MFCs and related FFCs; and the type of report to be issued and the deficiencies or significant deficiencies to be included in such report and to resolve any disagreements (see paragraphs .91–.92).

xi. Prepare a written report on the results of the review (see paragraphs .94–.96).

xii. Review and provide comments to the reviewed firm on its response to the report, if applicable (see paragraphs .97–.101).

**Planning Considerations**

**.39** To assist the review team in the planning of the review, the team captain should obtain the prior peer review report, the letter of response, if applicable, and the letter of acceptance, all from the reviewed firm. The team captain should also obtain the prior FFC forms, if applicable (from the administering entity if the team captain's firm did not perform the prior peer review). The team captain should consider whether the issues discussed in those documents require additional emphasis in the current review and, in the course of the review, should evaluate the actions of the firm in response to the prior report.

**.40** The reviewer should inquire of the firm regarding the areas to be addressed in the written representation (see paragraph .05(*f*) and appendix B) and consider whether the areas discussed require additional emphasis in the course of the review (see interpretations).

**Understanding the Firm's Accounting and Auditing Practice and System of Quality Control**

**.41** The review team should obtain a sufficient understanding of the nature and extent of the reviewed firm's accounting and auditing practice to plan the review. This understanding should include knowledge about the reviewed firm's organization and philosophy, as well as the composition of its accounting and auditing practice.

**.42** The review team should also obtain a sufficient understanding of the reviewed firm's system of quality control with respect to each of the quality control elements in SQCS No. 8 to plan the review (see interpretations). SQCS No. 8 requires every CPA firm, regardless of its size, to have a system of quality control for its accounting and auditing practice. It states that the quality control policies and procedures applica-

ble to a professional service provided by the firm should encompass the following elements: leadership responsibilities for quality within the firm (the "tone at the top"); relevant ethical requirements (such as independence, integrity and objectivity); acceptance and continuance of client relationships and specific engagements; human resources; engagement performance; and monitoring. It also states that the nature, extent, and formality of a firm's quality control policies and procedures should be appropriately comprehensive and suitably designed in relation to the firm's size, the number of its offices, the degree of operating autonomy allowed its personnel and its offices, the knowledge and experience of its personnel, the nature and complexity of the firm's practice, and appropriate cost-benefit considerations.

**.43** The understanding obtained by the review team should include knowledge about the design of the reviewed firm's quality control policies and procedures in accordance with quality control standards established by the AICPA and how the policies and procedures identify and mitigate risk of material noncompliance with applicable professional standards.

**.44** The understanding of the firm's accounting and auditing practice and system of quality control is ordinarily obtained through such procedures as inquiries of appropriate management and other personnel, reviewing the firm's internal policies and procedures, and reviewing the firm's responses to questionnaires developed by the board.

**.45** The review team should obtain a sufficient understanding of the reviewed firm's monitoring policies and procedures since its last peer review and their potential effectiveness. In doing so, the review team may determine that the firm's current year's internal monitoring procedures could enable the review team to reduce, in a cost-beneficial manner, the number of offices and engagements selected for review or the extent of the other testing (see interpretations).

**Understanding and Assessing Peer Review Risk Factors**

**.46** Just as the performance of an audit involves audit risk, the performance of a System Review involves peer review risk. Peer review risk is the risk that the review team:

*a.* Fails to identify significant weaknesses in the reviewed firm's system of quality control for its accounting and auditing practice, its lack of compliance with that system, or a combination thereof.

*b.* Issues an inappropriate opinion on the reviewed firm's system of quality control for its accounting and auditing practice, its compliance with that system, or a combination thereof.

*c.* Reaches an inappropriate decision about the matters to be included in, or excluded from, the report.

**.47** Peer review risk consists of the following two parts:

*a.* The risk (consisting of *inherent risk* and *control risk*) that an engagement will not be performed or reported on in conformity with applicable professional standards in all material respects, that the reviewed firm's system of quality control will not prevent such failure, or both. [fn 9] [fn 10]

---

[fn 9] Inherent risk is the likelihood that an accounting or auditing engagement will fail to conform to professional standards, assuming the firm does not have a system of quality control.

*b.* The risk (*detection risk*) that the review team will fail to detect and report on the design or compliance deficiencies or significant deficiencies in the reviewed firm's system of quality control.

**.48** Inherent risk and control risk relate to the reviewed firm's accounting and auditing practice and its system of quality control. These risks may be affected by circumstances arising within the firm (for example, individual partners have engagements in numerous specialized industries or the firm has a few engagements constituting a significant portion of the firm's accounting and auditing practice) or outside the firm (for example, new professional standards being applied for the first time or adverse economic developments in an industry).

***Assessing Peer Review Risk***

**.49** In planning the review, the review team should use the understanding it has obtained of the reviewed firm's accounting and auditing practice and its system of quality control to assess the inherent and control risks. The assessment of risks is qualitative and not quantitative. The lower the inherent and control risk, the higher the detection risk that can be tolerated and vice versa. Based on its assessment of inherent and control risk, the review team determines the acceptable level of detection risk.

**.50** When assessing risk, the review team should evaluate the reviewed firm's quality control policies and procedures over its accounting and auditing practice in relation to the requirements contained in SQCS No. 8. This evaluation provides a basis for the review team to determine whether the reviewed firm has adopted appropriately comprehensive and suitably designed policies and procedures that are relevant to the size and nature of its practice.

***Relationship of Risk to Scope***

**.51** The review team should consider the combined assessed levels of inherent and control risk when selecting offices and engagements to be reviewed. The higher the combined assessed levels of inherent and control risk, the higher the peer review risk. To reduce the peer review risk to an acceptable low level, the detection risk needs to be low, and thus the greater the scope (that is, the greater the number of offices that should be visited or the greater the number of engagements that should be reviewed, or both). Conversely, the lower the combined assessed levels of inherent and control risk, the smaller the scope that needs to be considered for review. The combined assessed levels of inherent and control risk may vary among offices and engagements so that the scope may be greater for some types of offices and engagements than for others.

**.52** However, even when the combined assessed levels are low, the peer review team must review some engagements to obtain reasonable assurance that the reviewed firm is complying with its quality control policies and procedures and applicable professional standards. For the review team to obtain such assur-

---

[fn 10] Control risk is the risk that a firm's system of quality control will not prevent the performance of an engagement that does not conform to professional standards. It consists of two parts: the firm's control environment and its quality control policies and procedures. The control environment represents the collective effort of various factors on establishing, enhancing, or mitigating the effectiveness of specific quality control policies and procedures. The control environment reflects the overall attitude, awareness, and actions of firm management concerning the importance of quality work and its emphasis in the firm.

ance, a reasonable cross section of the reviewed firm's accounting and auditing engagements must be reviewed or inspected, with greater emphasis on those portions of the practice with higher combined assessed levels of inherent and control risk (see interpretations).

**Planning and Performing Compliance Tests**

**.53** After performing the aforementioned planning procedures, the team captain should then develop a general plan for the nature and extent of conducting compliance tests of engagements (to directly test the "engagement performance" element in SQCS No. 8) and the other elements described in SQCS No. 8 (collectively referred to as the *functional areas*). The compliance tests should be tailored to the practice of the reviewed firm and, taken as a whole, should be sufficiently comprehensive to provide a reasonable basis for concluding whether the reviewed firm's system of quality control was complied with to provide the firm with reasonable (not absolute) assurance of performing and reporting in conformity with applicable professional standards in the conduct of its accounting and auditing practice in all material respects.

**.54** Such tests should be performed at the practice office(s) visited and should relate to individual engagements and the functional areas. The tests should include the following:

*a.* Review significant risk areas (see paragraph .65) on selected engagements, including accounting and auditing documentation, and reports, to evaluate whether the engagements were performed and reported on in conformity with applicable professional standards and in compliance with relevant firm quality control policies and procedures.

*b.* Interview firm personnel at various levels and, if applicable, other persons responsible for a function or activity to assess their understanding of, and compliance with, the firm's quality control policies and procedures.

*c.* Review evidential material to determine whether the firm has complied with its policies and procedures for monitoring its system of quality control.

*d.* Review other evidential material as appropriate. Examples include selected administrative or personnel files, correspondence files documenting consultations on technical or ethical questions, files evidencing compliance with human resource requirements, and the firm's technical reference sources (see interpretations).

***Scope Limitations***

**.55** There is a presumption that all engagements and all aspects of functional areas otherwise subject to the peer review will be included in the scope of the review. However, in the rare situations when exclusions or other limitations on the scope of the review are being contemplated, a team captain should carefully consider the implications of such exclusion. This includes communicating to the firm and the administering entity the effect on the review and on the ability of the team captain to issue a peer review report (see interpretations).

***Selection of Offices***

**.56** Visits to practice offices should be sufficient to provide the review team with a reasonable basis for its conclusions regarding whether the reviewed firm's quality control policies and procedures are adequately communicated throughout the firm and whether its system of quality control was complied with during

the year under review based on a reasonable cross section of the reviewed firm's accounting and auditing practice, with greater emphasis on those offices with higher assessed levels of peer review risk. Examples of the factors to consider when assessing peer review risk at the office level include the following (see interpretations):

*a.* The number, size, and geographic distribution of offices

*b.* The degree of centralization of accounting and auditing practice control and supervision

*c.* The review team's evaluation, if applicable, of the firm's monitoring procedures

*d.* Recently merged or recently opened offices

*e.* The significance of industry concentrations and of specialty practice areas, such as governmental compliance audits or regulated industries, to the firm and to individual offices

*f.* Extent of non-audit services to audit clients

*g.* Significant clients 'fees to practice office(s) and partner(s)

**.57** For a multi-office firm, the review should include, in addition to any offices selected using the risk-based criteria, a visit to the firm's executive office if one is designated as such.

***Selection of Engagements***

**.58** Engagements subject to selection for review ordinarily should be those with periods ending during the year under review, except financial forecasts or projections and agreed upon procedures (see interpretations). Financial forecasts or projections and agreed upon procedures with report dates during the year under review would be subject to selection. If the current year's engagement has not been completed and issued, and if a comparable engagement within the peer review year is not available, the prior year's engagement may be reviewed. If the subsequent year's engagement has been completed and issued, the review team should consider, based on its assessment of peer review risk, whether the more recently completed and issued engagement should be reviewed instead (see interpretations). Review team members should not have contact with or access to any client of the reviewed firm in connection with the peer review.

**.59** Engagements selected for review should provide a reasonable cross section of the reviewed firm's accounting and auditing practice, with greater emphasis on those engagements in the practice with higher assessed levels of peer review risk. Examples of the factors to consider when assessing peer review risk at the engagement level include size; industry area; level of service; personnel (including turnover, use of merged-in personnel, or personnel not routinely assigned to accounting and auditing engagements); communications from regulatory, monitoring, or enforcement bodies; extent of non-audit services to audit clients; significant clients 'fees to practice office(s) and partner(s); and initial engagements (see interpretations).

**.60** The review of engagements should usually be directed toward the accounting and auditing work performed by the practice office visited, including the work performed on those engagements by other practice offices of the reviewed firm or other public accounting firms. For those situations in which the practice office being visited performed accounting and auditing work for another practice office, the review team may limit its review to portions of the engagements performed by the practice office being visited but should evaluate the appropriateness of the instructions issued by the other practice office and the ade-

quacy of the procedures followed in performing and reporting in conformity with applicable professional standards. When combined with other procedures performed, the number and type of accounting and auditing engagements selected by the review team for review should be sufficient to provide the review team with a reasonable basis for its conclusions regarding the reviewed firm's system of quality control.

**.61** The initial selection of engagements to be reviewed should ordinarily be provided to the reviewed firm no earlier than three weeks prior to the commencement of the peer review procedures at the related practice office or location. This should provide ample time to enable the firm (or office) to assemble the required client information and engagement documentation before the review team commences the review. However, at least one engagement from the initial selection to be reviewed should be provided to the firm once the review commences and not provided to the firm in advance. Ordinarily, based on the nature of the firm's practice and assuming that the engagement would not be automatically anticipated for selection by the reviewed firm, the engagement should be an audit. Otherwise, the engagement should be the firm's next highest level of service where the same criteria can be met. This should not increase the scope of the review (see interpretations).

**.62** The process of engagement selection, except as noted in paragraph .63, like office selection, is not subject to definitive criteria. Nevertheless, if the team captain finds that meeting all of the preceding criteria results in the selection of an inappropriate scope of the firm's accounting and auditing practice, the team captain should consult with the administering entity about the selection of engagements for review (see interpretations).

**.63** Specific types or number of engagements must be selected in a System Review (see interpretations).

***Extent of the Review of Engagements***

**.64** The review of engagements should include the review of financial statements, accountants 'reports, accounting and audit documentation, and correspondence, as well as discussions with professional personnel of the reviewed firm.

**.65** Audit engagements have areas in which risk may be inherently significant, such as, but not limited to, fraud considerations, use of estimates, emerging issues, and assertions that are difficult to audit. The review team's procedures should include determining whether the reviewed firm has appropriately:

*a.* Identified the significant risk areas on each audit engagement selected for the peer review,

*b.* Performed the necessary audit procedures related to the identified significant risk areas, and

*c.* Documented the auditing procedures performed in these significant risk areas.

***Concluding on the Review of an Engagement***

**.66** For each engagement reviewed, the review team should conclude on its review by documenting whether anything came to its attention that caused it to believe that the engagement was not performed or reported on in conformity with applicable professional standards in all material respects (see interpretations).

**.67** The team captain should promptly inform the firm when an engagement is not performed or reported on in conformity with applicable professional standards and remind the firm of its obligation under professional standards to take appropriate actions (see interpretations).

***Expansion of Scope***

**.68** If, during the peer review, the review team concludes that there was a failure to reach an appropriate conclusion on the application of professional standards in all material respects on one or more of the reviewed engagements, the review team should consider whether the application of additional peer review procedures is necessary. This consideration should be documented in the peer review working papers. The objective of the application of additional procedures would be to determine whether the failure is indicative of a pattern of such failures, whether it is a significant deficiency in the design of the reviewed firm's system of quality control or in its compliance with the system, or whether it is both. In some circumstances, the reviewer may conclude that, because of compensating controls or for other reasons, further procedures are unnecessary. If, however, additional procedures are deemed necessary, they may include an expansion of scope to review all or relevant portions of one or more additional engagements or aspects of functional areas. Additional engagements may be in the same industry, supervised by the same individual in the reviewed firm, or otherwise have characteristics associated with the failure to perform or report in conformity with professional standards.

**Identifying Matters, Findings, Deficiencies, and Significant Deficiencies**

**.69** In understanding the firm's system of quality control, the team captain may note that the system is not designed appropriately. Similarly, the performance of compliance tests may uncover that the system is not being complied with appropriately or may identify a design weakness that was not identified during the planning of the peer review. With any of these items, the team captain has available a set of definitions to assist in classifying the condition noted.

**.70** Determining the relative importance of matters noted during the peer review, individually or combined with others, requires professional judgment. Careful consideration is required in forming conclusions. The descriptions that follow, used in conjunction with practice aids (MFC, DMFC, and FFC forms) to document these items when applicable, are intended to assist in aggregating and evaluating the peer review results, concluding on them, and determining the nature of the peer review report to issue:

*a.* A peer reviewer notes a *matter* as a result of his or her evaluation of the design of the reviewed firm's system of quality control or tests of compliance with it. Tests of compliance include inspection, inquiry, and observation performed by reviewing engagements and testing other aspects of the reviewed firm's system of quality control. Matters are typically one or more "No" answers to questions in peer review questionnaire(s) that a reviewer concludes warrants further consideration in the evaluation of a firm's system of quality control. A matter is documented on a Matter for Further Consideration (MFC) form.

*b.* A *finding* is one or more related matters that result from a condition in the reviewed firm's system of quality control or compliance with it such that there is more than a remote possibility that the reviewed firm would not perform or report in conformity with applicable professional standards. A peer reviewer will conclude whether one or more findings are a deficiency or significant deficiency. If the peer reviewer concludes that no finding, individually or combined with others, rises to the level of deficiency or significant deficiency, a report rating of *pass* is appropriate. A finding not rising to the level of a deficiency or significant deficiency is documented on a Finding for Further Consideration (FFC) form.

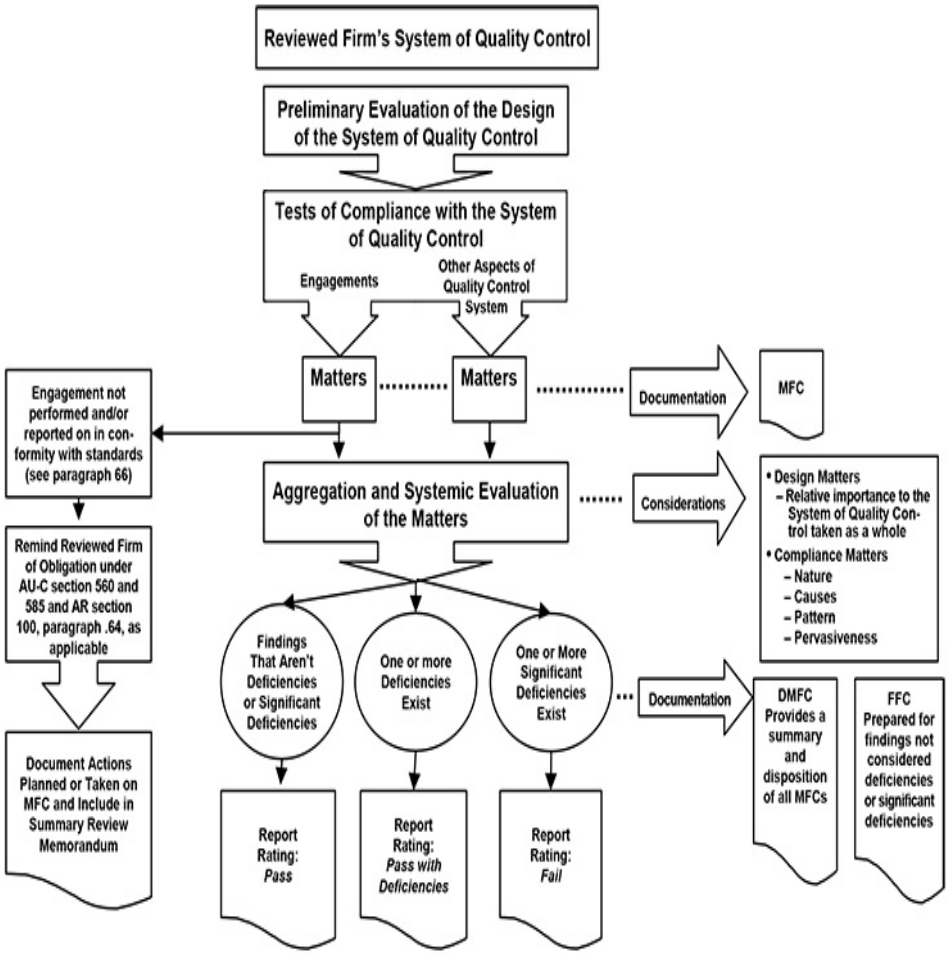
*c.* A *deficiency* is one or more findings that the peer reviewer has concluded, due to the nature, causes, pattern, or pervasiveness, including the relative importance of the finding to the reviewed firm's system of quality control taken as a whole, could create a situation in which the firm would not have reasonable assurance of performing or reporting in conformity with applicable professional standards in one or more important respects. It is not a significant deficiency if the

peer reviewer has concluded that except for the deficiency or deficiencies, the reviewed firm has reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Such deficiencies are communicated in a report with a peer review rating of *pass with deficiencies*.

*d.* A *significant deficiency* is one or more deficiencies that the peer reviewer has concluded results from a condition in the reviewed firm's system of quality control or compliance with it such that the reviewed firm's system of quality control taken as a whole does not provide the reviewed firm with reasonable assurance of performing or reporting in conformity with applicable professional standards in all material respects. Such deficiencies are communicated in a report with a peer rating of *fail*.

**.71** A broad understanding of the peer review process, from the preliminary evaluation of the design of the system of quality control, to the tests of compliance, to the decision making process of determining whether an item noted during a System Review is a matter, finding, deficiency, or significant deficiency, is shown in exhibit A. The exhibit also illustrates the aggregation of these items, where those items are documented in the practice aids and how they might affect the type of report issued.

**Exhibit A**



**.72** As described by exhibit A in paragraph .71, depending on the resolution of a matter and the process of aggregating and evaluating peer review results, a matter may develop into a finding. Findings will also be evaluated and, after considering the nature, causes, pattern, pervasiveness, and relative importance to the system of quality control as a whole, may not get elevated to a deficiency. A matter may develop into a finding and get elevated to a deficiency. That deficiency may or may not be further elevated to a significant deficiency.

**.73** A matter is documented on a MFC form. If the matter, after further evaluation, gets elevated to a finding but not a deficiency or significant deficiency, it is documented on a FFC form. The FFC form is a standalone document that includes the reviewer's recommendation and the reviewed firm's response regarding actions planned or taken and the timing of those actions by the firm. MFC and FFC forms are subject to review and oversight by the administering entity, who will evaluate the reviewed firm's FFC form responses for appropriateness and responsiveness (see paragraphs .141–.145) and determine whether any further action is necessary. If the matter documented on the MFC form is instead elevated to a deficiency or significant deficiency, then it is communicated in the report itself, along with the reviewer's recommendation. The firm submits a letter of response regarding actions planned or taken and the timing of those actions by the firm, which is also evaluated for appropriateness and responsiveness (see paragraphs .139–.140).

**.74** In order to document the disposition of all the MFCs, the team captain completes a DMFC form. The DMFC form is part of the working papers and provides a trail of the disposition of the MFCs for the peer reviewer, administering entity, and individuals conducting technical reviews or oversight. All of the MFCs are identified on the DMFC form with an indication after each as to whether it was cleared, discussed with the firm during the exit conference, included on a specific FFC form (individually or combined with other MFCs), or included as a deficiency in a report with a peer review rating of *pass with deficiencies* or as a significant deficiency in a report with a peer review rating of *fail*.

### Aggregating and Systemically Evaluating Matters

**.75** To conclude on the results of a peer review, the review team must aggregate the matters noted during the peer review and determine whether the matters were the result of the design of the reviewed firm's system of quality control or the failure of its personnel to comply with the firm's quality control policies and procedures. The review team should consider their relative importance to the firm's system of quality control as a whole and their nature, causes, pattern, and pervasiveness.

**.76** Use of professional judgment is essential in determining whether the aggregation of the matters noted during the review are findings and whether one or more findings is a deficiency or significant deficiency for purposes of reporting on the results of the peer review.

#### *Design Matters*

**.77** A design matter exists when the reviewed firm's system of quality control is missing a quality control policy or procedure or the reviewed firm's existing quality control policies and procedures, even if fully complied with, would not result in engagements performed or reported on in accordance with professional standards in some respect. To be effective, a system of quality control must be designed properly, and all of the quality control policies and procedures necessary to provide the reviewed firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects should be in place. Therefore, the review team will need to determine whether the quality control policies and procedures would be effective if they were complied with. To make this determination, the review team should consider the implications of the evidence obtained during its evaluation of the

system of quality control and its tests of compliance, including its reviews of engagements. For example, a pattern of engagement failures to perform or report in conformity with applicable professional standards in all material respects (that is, failures requiring the application of AU-C section 560, *Subsequent Events and Subsequently Discovered Facts*, or AU-C section 585, *Consideration of Omitted Procedures After the Report Release Date* [AICPA, *Professional Standards*]), likely is indicative of a finding pertaining to the design of the reviewed firm's quality control policies and procedures.

**.78** As noted in SQCS No. 8, "The nature of the policies and procedures developed by individual firms to comply with this Statement will depend on various factors such as the size and operating characteristics of the firm." Likewise, 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. For example, a matter noted during the review of a quality control policy or procedures may be particularly or wholly offset by another policy or procedure. In this circumstance, the review team should consider the interrelationships among the elements of quality and weigh the matters noted against compensating policies and procedures to determine whether a finding exists and its relative importance.

**.79** There may be circumstances in which the reviewer finds few findings in the work performed by the firm and yet may conclude that the design of the firm's system of quality control needs to be improved. For example, a firm that is growing rapidly and adding personnel and clients may not be giving appropriate attention to the policies and procedures necessary in areas such as human resources (hiring, assigning personnel to engagements, and advancement) and acceptance and continuance of clients and engagements. A reviewer might conclude that these conditions could create a situation in which the firm would not have reasonable assurance of performing or reporting in conformity with applicable professional standards in one or more important respects. However, in the absence of findings in the engagements reviewed, the reviewer would ordinarily conclude that the matter should be addressed in a FFC as a finding rather than result in a report with a peer review rating of *pass with deficiencies* or *fail*.

***Compliance Matters***

**.80** A compliance matter exists when a properly designed quality control policy or procedure does not operate as designed because of the failure of the personnel of the reviewed firm to comply with it. Because a variance in individual performance and professional interpretation will affect the degree of compliance, adherence to all policies and procedures in every case generally is not possible. However, the degree of compliance by the personnel of the reviewed firm with its prescribed quality control policies and procedures should be adequate to provide the reviewed firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.

**.81** In assessing whether the degree of compliance was adequate to provide the required assurance, the review team should consider the nature, causes, pattern, and pervasiveness of the instances of noncompliance noted and their relative importance to the firm's system of quality control as a whole, not merely their importance in the specific circumstances in which they were observed. As with the evaluation of design matters, compliance matters also need to be evaluated in the context of the firm's size, organizational structure, and the nature of its practice.

**.82** To determine the degree of noncompliance, the review team should evaluate the matters of noncompliance, both individually and in the aggregate, recognizing that adherence to certain policies and procedures of the reviewed firm is more critical to the firm obtaining reasonable assurance of performing and reporting in conformity with applicable professional standards than adherence to others. In this context, the review team should consider the likelihood that noncompliance with a given quality control policy or procedure

could have resulted in engagements not being performed or reported on in conformity with applicable professional standards in all material respects. The more direct the relationship between a specific quality control policy or procedure and the application of professional standards, the lower the degree of noncompliance necessary to determine whether a matter (or matters) is a finding and whether a finding is a deficiency or significant deficiency.

***Determining the Cause for a Finding***

**.83** When the review team is faced with an indication that a matter(s) could be a finding, or the firm failed to perform or report in conformity with applicable professional standards in all material respects, the review team's first task in such circumstances is to determine the cause of the finding or failure (see interpretations). Causes that might be systemic and might affect the type of peer review report issued include, but are not limited to, the following:

*a.* The failure related to a specialized industry practice, and the firm had no experience in that industry and made no attempt to acquire training in the industry or to obtain appropriate consultation and assistance.

*b.* The failure related to an issue covered by a recent professional pronouncement, and the firm had failed to identify, through professional development programs or appropriate supervision, the relevance of that pronouncement to its practice.

*c.* The failure should have been detected if the firm's quality control policies and procedures had been followed.

*d.* The failure should have been detected by the application of quality control policies and procedures commonly found in firms similar in size or nature of practice. That judgment can often be made by the reviewer based on personal experience or knowledge; in some cases, the reviewer will wish to consult with the administering entity before reaching such a conclusion.

**.84** The finding or failure to perform or report in conformity with applicable professional standards in all material respects may be the result of an isolated human error and, therefore, would not necessarily mean that a peer review report with a peer review rating of *pass with deficiencies* or *fail* should be issued (see interpretations). However, if the reviewer believes that the probable cause (for example, a failure to provide or follow appropriate policies for supervision of the work of assistants) of a finding or failure to perform or report in conformity with applicable professional standards in all material respects on an engagement or a finding within a functional area also exists in other engagements or in other functional areas, the reviewer needs to consider carefully the need to issue a peer review report with a peer review rating of *pass with deficiencies* or *fail*.

**.85** Although an isolated matter or an instance of noncompliance with the firm's quality control policies and procedures ordinarily would not be included in the report, its nature, cause (if determinable), and relative importance for the firm's system of quality control as a whole should be evaluated in conjunction with the review team's other findings before making a final determination (see interpretations).

***The Pattern and Pervasiveness of Matters***

**.86** The review team must consider the pattern and pervasiveness of 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. As noted in the preceding para-

graphs, the review team's first task is to try to determine why the matters occurred. In some cases, the design of the firm's system of quality control may be deficient (for example, when it does not provide for timely involvement in the planning process by a partner of the firm or there is inadequate supervision of engagement planning). In other cases, there may be a pattern of noncompliance with a quality control policy or procedure such as when firm policy requires the completion of a financial statement disclosure checklist but such checklists often were not used or relevant questions or points were incorrectly considered. That increases the possibility that the firm might not perform or report in conformity with applicable professional standards in all material respects, which also means that the reviewer must consider carefully whether the matter(s) individually or in the aggregate is (are) a deficiency or a significant deficiency and whether there is the need to issue a peer review report with a peer review rating of *pass with deficiencies* or *fail*. On the other hand, the types of matters noted may be individually different, not individually significant, and not directly traceable to the design of or compliance with a particular quality control policy or procedure. This may lead the reviewer to the conclusion that the matters were isolated cases of human error that should not result in a peer review report with a peer review rating of *pass with deficiencies* or *fail*.

**Forming Conclusions on the Type of Report to Issue in a System Review**

**.87** The team captain must use professional judgment in determining the type of peer review report to issue. This judgment requires the consideration of several factors, including an understanding of the firm's system of quality control and the nature, causes, pattern, and pervasiveness of matters and their relative importance to the firm's system of quality control taken as a whole, including limitations on the scope of the review.

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

**.88** A report with a peer review rating of *pass* should be issued when the team captain concludes that the firm's system of quality control for the accounting and auditing practice 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. There are no deficiencies or significant deficiencies that affect the nature of the report and, therefore, the report does not contain any deficiencies, significant deficiencies, or recommendations. In the event of a scope limitation, a report with a peer review rating of *pass (with a scope limitation)* is issued.

***System Review Report With a Peer Review Rating of Pass With Deficiencies***

**.89** A report with a peer review rating of *pass with deficiencies* should be issued when the team captain concludes that the firm's system of quality control for the accounting and auditing practice 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 with the exception of a certain deficiency or deficiencies that are described in the report. These deficiencies are conditions related to the firm's design of and compliance with its system of quality control that could create a situation in which the firm would have less than reasonable assurance of performing or reporting in conformity with applicable professional standards in one or more important respects due to the nature, causes, pattern, or pervasiveness, including the relative importance of the deficiencies to the quality control system taken as a whole. In the event of a scope limitation, a report with a peer review rating of *pass with deficiencies (with a scope limitation)* is issued.

**System Review Report With a Peer Review Rating of Fail**

**.90** A report with a peer review rating of *fail* should be issued when the team captain has identified significant deficiencies and concludes that the firm's system of quality control is not suitably designed to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects or the firm has not complied with its system of quality control to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. In the event of a scope limitation, a report with a peer review rating of *fail (with a scope limitation)* is issued.

**Communicating Conclusions at the Exit Conference**

**.91** A firm that has a System Review should respond promptly to questions raised in the review in order to assist the review team in reaching its conclusions. Prior to issuing its report or finalizing FFC form(s), if applicable, the review team should communicate its conclusions to senior members of the reviewed firm at an exit conference (see interpretations). Ordinarily, the team captain should be physically present at the exit conference, unless the System Review is performed at a location other than the reviewed firm's office. The exit conference may also be attended by representatives of the administering entity, the board, AICPA staff, or other board authorized organizations with oversight responsibilities.

**.92** The reviewed firm is entitled to be informed at the exit conference about any matters documented on the MFC form(s), findings documented on the FFC form(s), deficiencies or significant deficiencies to be included in the peer review report, and the type of report to be issued. Accordingly, except in rare circumstances that should be explained to the reviewed firm, the exit conference should be postponed if there is any uncertainty about the report to be issued or the deficiencies or significant deficiencies to be included in the report. The review team should also communicate, if applicable, that the firm will be required to respond to the findings documented on the FFC form(s), or the deficiency(ies) or significant deficiencies included in the peer review report. The review team should also communicate that the firm may be required, if applicable, to (1) take certain actions to correct the deficiencies or significant deficiencies noted in the report or (2) complete an implementation plan to address the findings noted in the FFC form(s). The review team should also discuss with the reviewed firm the implications of these steps on the acceptance and completion of the peer review and the reviewed firm's enrollment in the program. The exit conference is also the appropriate vehicle for providing suggestions to the firm that are not included in the report, FFC form(s), or MFC form(s).

**Addressing Disagreements Between the Reviewer and the Reviewed Firm**

**.93** Disagreements may arise during attempts to resolve various issues, for instance, related to the review of particular engagements, the systemic cause of a deficiency, or issues related to a design deficiency. In addition, there could be a disagreement on the appropriate approach to be taken in performing or reporting in conformity with applicable professional standards, or the review team might not believe that the actions planned or taken by the firm, if any, are appropriate (for example, if the reviewed firm believes that it can continue to support a previously issued report and the review team continues to believe that there may be a failure to reach appropriate conclusions in the application of professional standards). Reviewers and reviewed firms should understand that professional judgment often becomes a part of the process and that each party has the right to challenge each other on an issue. Nevertheless, a disagreement during the resolution of an issue may persist in some circumstances. The reviewed firm or reviewer should consult with their administering entity and, if necessary, request that a panel of the administering entity's peer review committee members resolve the disagreement. The panel must reach a decision to resolve the disagreement. Any of the disagreeing parties may request an appeal by writing the board and explaining why he or she believes a review of the panel's decision is warranted. A panel formed by the

board will review and consider the request and take further action pursuant to fair procedures that it has established.

## Reporting on System Reviews

### General

**.94** The team captain should furnish the reviewed firm with a written report within 30 days of the exit conference date or by the firm's peer review due date, whichever is earlier. A report on a review performed by a firm is to be issued on the letterhead of the firm performing the review. A report by a review team formed by an association of CPA firms is to be issued on the letterhead of the firm of the team captain performing the review. The report in a System Review ordinarily should be dated as of the date of the exit conference. See interpretations for guidance on notification requirements and submission of peer review documentation to the administering entity.

### Preparing the Report in a System Review

**.95** The standard form for a report with a peer review rating of *pass* is illustrated in appendix C, "Illustration of a Report With a Peer Review Rating of *Pass* in a System Review." Illustrations of reports with a peer review rating of *pass with deficiencies* and *fail* are presented in appendixes E, "Illustration of a Report With a Peer Review Rating of *Pass With Deficiencies* in a System Review," and I, "Illustration of a Report With a Peer Review Rating of *Fail* in a System Review," respectively. Illustrations of reports with a peer review rating of *pass (with a scope limitation)*, *pass with deficiencies (with a scope limitation)*, and *fail (with a scope limitation)* are presented in appendixes D, "Illustration of a Report With a Peer Review Rating of *Pass (With a Scope Limitation)* in a System Review;" G, "Illustration of a Report With a Peer Review Rating of *Pass With Deficiencies (With a Scope Limitation)* in a System Review;" and K, "Illustration of a Report With a Peer Review Rating of *Fail (With a Scope Limitation)* in a System Review," respectively.

**.96** The written report in a System Review should:

*a.* State at the top of the report the title "System Review Report."

*b.* State that the system of quality control for the accounting and auditing practice of the firm was reviewed and include the year-end covered by the peer review.

*c.* State that the peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the AICPA.

*d.* State that 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.

*e.* State that the reviewer's responsibility is to express an opinion on the design of the system of quality control and the firm's compliance therewith based on the review.

*f.* State that the nature, objectives, scope, limitations of, and procedures performed in a System Review are described in the standards.

*g.* Include a URL reference to the AICPA website where the standards are located.

*h.* Identify engagement types required to be selected by the board in the interpretations, when applicable.

*i.* Identify the different peer review ratings that the firm could receive.

*j.* In a report with a peer review rating of *pass*:

- Express an opinion that the system of quality control for the accounting and auditing practice of the reviewed firm in effect for the year-ended 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.

- State at the end of the opinion paragraph that therefore the firm has received a peer review rating of *pass*.

- In the event of a scope limitation, include an additional paragraph before the opinion paragraph that describes the relationship of the excluded engagement(s) or functional area(s) to the reviewed firm's practice as a whole, the highest level of service and industry concentration, if any, of the engagement(s) excluded from potential selection, and the effect of the exclusion on the scope and results of the peer review.

- Reports with a peer review rating of *pass* do not contain any findings, deficiencies, significant deficiencies, or recommendations.

*k.* In a report with a peer review rating of *pass with deficiencies*: [fn 11]

- Express an opinion that, except for the deficiencies previously described, the system of quality control for the accounting and auditing practice of the reviewed firm in effect for the year-ended 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.

- State at the end of the opinion paragraph that therefore the firm has received a peer review rating of *pass with deficiencies*.

- In the event of a scope limitation, include an additional paragraph before the deficiencies that describes the relationship of the excluded engagement(s) or functional area(s) to the reviewed firm's practice as a whole, the highest level of service and industry concentration, if any, of the engagement(s) excluded from potential selection, and the effect of the exclusion on the scope and results of the peer review.

*l.* In a report with a peer review rating of *fail*:

---

[fn 11] Reference to plural could also apply to a singular item within the standards. For instance, there could be deficiencies or a deficiency. The wording in the peer review report should be tailored as necessary.

- Express an opinion that as a result of the significant deficiencies previously described, the system of quality control for the accounting and auditing practice of the reviewed firm in effect for the year-ended was not suitably designed or complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.

- State at the end of the opinion paragraph that therefore the firm has received a peer review rating of *fail*.

- In the event of a scope limitation, include an additional paragraph before the significant deficiencies that describes the relationship of the excluded engagement(s) or functional area(s) to the reviewed firm's practice as a whole, the highest level of service and industry concentration, if any, of the engagement(s) excluded from potential selection, and the effect of the exclusion on the scope and results of the peer review.

*m.* Include, for reports with a peer review rating of *pass with deficiencies* or *fail*, systemically written descriptions of the deficiencies or significant deficiencies and the reviewing firm's recommendations (each of these should be numbered) (See interpretations).

*n.* Identify, for any deficiencies or significant deficiencies included in the report with a peer review rating of *pass with deficiencies* or *fail*, any that were also made in the report issued on the firm's previous peer review (see interpretations). This should be determined based on the underlying systemic cause of the deficiencies or significant deficiencies.

*o.* Identify the level of service for any deficiencies or significant deficiencies. If the deficiency or significant deficiency included in the report with a peer review rating of *pass with deficiencies* or *fail* is industry specific, also identify the industry.

**Firm Responses in a System Review**

**.97** If the reviewed firm receives a report with a peer review rating of *pass with deficiencies* or *fail*, the reviewed firm should respond in writing to the deficiencies or significant deficiencies and related recommendations identified in the report. The letter of response should be addressed to the administering entity's peer review committee and should describe the actions planned (including timing) or taken by the reviewed firm with respect to each deficiency in the report. The reviewed firm should submit a copy of the report, and its letter of response, to the administering entity within 30 days of the date it received the report from the team captain or by the firm's peer review due date, whichever date is earlier. Prior to submitting the response to the administering entity, the reviewed firm should submit the response to the team captain for review, evaluation, and comment (see interpretations).

**.98** If the reviewed firm receives a report with a peer review rating of *pass* or *pass (with a scope limitation)*, a letter of response is not applicable, and the reviewed firm does not submit a copy of the report to the administering entity.

**.99** The reviewed firm should respond to all findings and related recommendations not rising to the level of a deficiency or significant deficiency on the related FFC forms. These responses should describe the plan the reviewed firm has implemented or will implement (including timing) with respect to each finding. The team captain should review and evaluate the responses on the FFC forms before they are submitted to the administering entity (see interpretations).

**.100** If, after a discussion with the team captain, the reviewed firm disagrees with one or more of the findings, deficiencies, or significant deficiencies, the reviewed firm should contact the administering entity for assistance in the matter (see paragraph .93). If the reviewed firm still disagrees with one or more of the findings, deficiencies, or significant deficiencies, its response on either the FFC form or in the letter of response, as applicable, should describe the reasons for the disagreement.

**.101** Illustrations of letters of response by a reviewed firm to reports in a System Review with a peer review rating of *pass with deficiencies* and *fail* are included in appendixes F, "Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Pass With Deficiencies* in a System Review;" H, "Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Pass With Deficiencies (With a Scope Limitation)* in a System Review;" J, "Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Fail* in a System Review;" and L, "Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Fail (With a Scope Limitation)* in a System Review."

## Performing Engagement Reviews

### Objectives

**.102** The objective of an Engagement Review is to evaluate whether engagements submitted for review are performed and reported on in conformity with applicable professional standards in all material respects. An Engagement Review consists of reading the financial statements or information submitted by the reviewed firm and the accountant's report thereon, together with certain background information and representations and the applicable documentation required by professional standards.

**.103** Engagement Reviews are not available to firms that perform engagements under the SASs, engagements under *Government Auditing Standards*, examinations under the SSAEs, or engagements performed under PCAOB standards. However, firms eligible to have an Engagement Review may elect to have a System Review (see interpretations).

### Basic Requirements

**.104** The criteria for selecting the peer review year-end and the period to be covered by an Engagement Review are the same as those for a System Review (see paragraphs .13–.19). Engagements subject to review ordinarily should be those with periods ending during the year under review, except for financial forecasts or projections and agreed upon procedures. Financial forecasts or projections and agreed upon procedures with report dates during the year under review would be subject to selection. The reviewed firm should provide summarized information showing the number of its compilation, review and preparation engagements performed under SSARS and engagements performed under the SSAEs, classified into industry categories. That information should be provided for each partner, or individual if not a partner, of the firm who is responsible for the issuance of reports on such engagements or the issuance of prepared financial statements with or without disclaimer reports. On the basis of that information, the review captain or the administering entity ordinarily should select the types of engagements to be submitted for review, in accordance with the following guidelines (see interpretations):

*a.* One engagement should be selected from each of the following areas of service performed by the firm:

1. Review of historical financial statements (performed under SSARS)

2. Compilation of historical financial statements, with disclosures (performed under SSARS)

3. Compilation of historical financial statements that omits substantially all disclosures (performed under SSARS)

4. Engagements performed under the SSAEs other than examinations

*b.* One engagement should be selected from each partner, or individual of the firm if not a partner, responsible for the issuance of reports listed in item *a*.

*c.* Selection of preparation engagements should only be made in the following instances:

1. One preparation engagement with disclosures (performed under SSARS) should be selected when performed by an individual in the firm who does not perform any engagements included in item *a* or when the firm's only engagements with disclosures are preparation engagements.

2. One preparation engagement that omits substantially all disclosures (performed under SSARS) should be selected when performed by an individual in the firm who does not perform any engagements included in item *a* or when the firm's only omit disclosure engagements are preparation engagements.

3. One preparation engagement should be selected if needed to meet the requirement in item *d*.

*d.* Ordinarily, at least two engagements should be selected for review.

**.105** The preceding criteria are not mutually exclusive. The objective is to ensure that one engagement is selected for each partner and one engagement is selected from each of the areas of service performed by the firm listed in item *a* in the previous list. Therefore, one of every type of engagement that a partner, or individual if not a partner, responsible for the issuance of the reports listed in item *a* in the previous list performs does not have to be reviewed as long as, for the firm taken as a whole, all types of engagements noted in item *a* in the previous list performed by the firm are covered.

**.106** The review captain should obtain the required representations submitted by the firm (see paragraph .05(*f*)) and should obtain the firm's prior peer review report, the letter response, if applicable, and the letter accepting those documents, all from the reviewed firm. The review captain should also obtain the prior FFC forms (from the administering entity if the review captain's firm did not perform the prior review).

**.107** For each engagement selected for review, the reviewed firm should submit the appropriate financial statements or information and the accountant's report, masking client identity if it desires, along with specified background information, representations about each engagement and the firm's documentation required by applicable professional standards for each of these engagements. There is a presumption that all engagements otherwise subject to the peer review will be included in the scope of the review. However, in the rare situations when exclusions or other limitations on the scope of the review are being contemplated, a review captain should carefully consider the implications of such exclusion. This includes communicating with the firm and the administering entity the effect on the review and on the ability of the review captain to issue a peer review report.

**.108** The evaluation of each engagement submitted for review includes the following:

*a.* Consideration of the financial statements or information and the related accountant's report on the compilation, review and preparation engagements performed under SSARS and engagements performed under SSAEs (see interpretations)

*b.* Consideration of the documentation on the engagements performed via reviewing background and engagement profile information, representations made by the firm, and inquiries

*c.* Review of all other documentation required by applicable professional standards on the engagements

**.109** An Engagement Review does not include a review of other documentation prepared on the engagements submitted for review (other than the documentation referred to in paragraphs .107–.108), tests of the firm's administrative or personnel files, interviews of selected firm personnel, or other procedures performed in a System Review (see interpretations). Accordingly, an Engagement Review does not provide the review captain with a basis for expressing any form of assurance on the firm's system of quality control for its accounting practice. The review captain's report does indicate, however, whether anything came to the review captain's attention that caused him or her to believe that the engagements submitted for review were not performed and reported on in conformity with applicable professional standards in all material respects (see interpretations). The review captain should promptly inform the firm when an engagement is not performed or reported on in conformity with applicable professional standards and remind the firm of its obligation under professional standards to take appropriate actions (see interpretations).

**Identifying Matters, Findings, Deficiencies, and Significant Deficiencies**

**.110** Determining the relative importance of matters noted during the peer review, individually or combined with others, is a matter of professional judgment. Careful consideration is required in forming conclusions. The descriptions that follow, used in conjunction with practice aids (MFC, DMFC, and FFC forms) to document these items, are intended to assist in determining the nature of the peer review report to issue:

*a.* A *matter* is noted as a result of evaluating whether an engagement submitted for review was performed or reported on in conformity with applicable professional standards. The evaluation includes reviewing the financial statements or information, the related accountant's reports, and the adequacy of procedures performed, including related documentation. Matters are typically one or more "No" answers to questions in peer review questionnaire(s). A matter is documented on a Matter for Further Consideration (MFC) form.

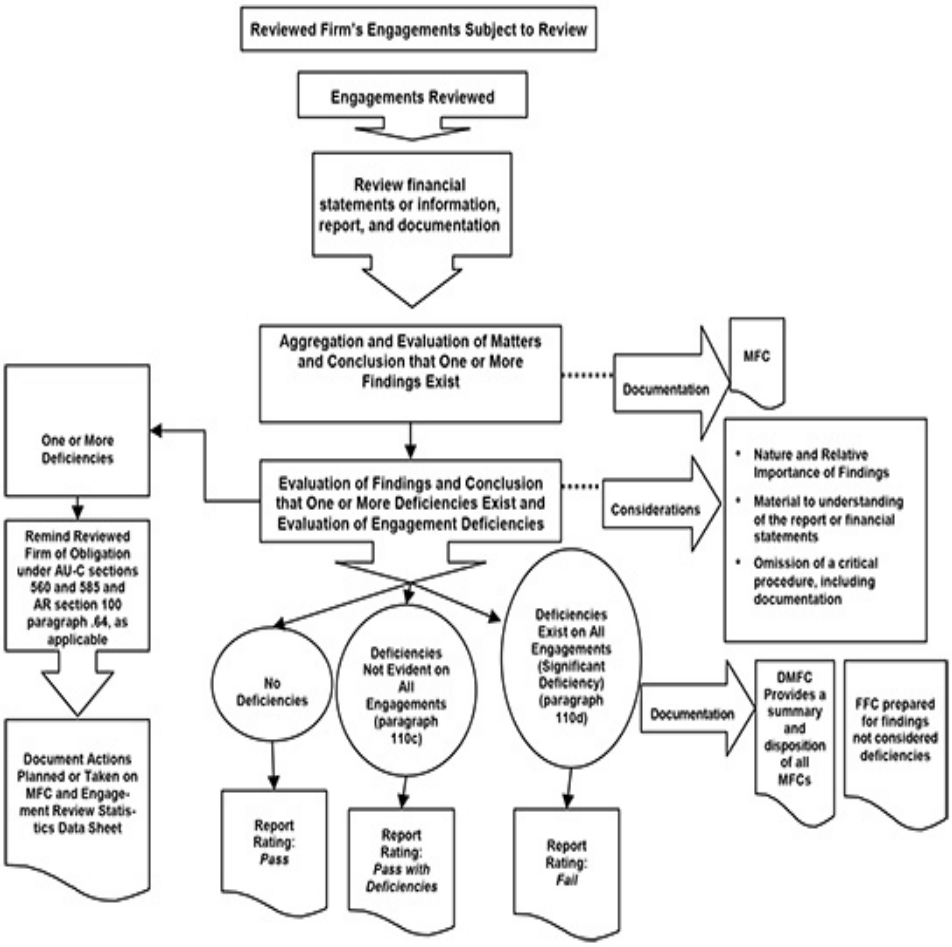
*b.* A *finding* is one or more matters that the review captain has concluded result in financial statements or information, the related accountant's reports submitted for review, or the procedures performed, including related documentation, not being performed or reported on in conformity with the requirements of applicable professional standards. A review captain will conclude whether one or more findings are a deficiency or significant deficiency. If the review captain concludes that no finding, individually or combined with others, rises to the level of deficiency or significant deficiency, a report rating of *pass* is appropriate. A finding not rising to the level of a deficiency or significant deficiency is documented on a Finding for Further Consideration (FFC) form.

*c.* A *deficiency* is one or more findings that the review captain concludes are material to the understanding of the financial statements or information or related accountant's reports or that represent omission of a critical procedure, including documentation, required by applicable professional standards. When a deficiency is noted, the review captain concludes that at least one but not all engagements submitted for review were not performed or reported on in conformity with applicable professional standards in all material respects. When the review captain concludes that deficiencies are not evident on all of the engagements submitted for review, such deficiencies are communicated in a report with a peer review rating of *pass with deficiencies*.

*d.* A *significant deficiency* exists when the review captain concludes that deficiencies are evident on all of the engagements submitted for review. When a significant deficiency is noted, the review captain concludes that all engagements submitted for review were not performed or reported on in conformity with applicable professional standards in all material respects. Such significant deficiencies are communicated in a report with a peer review rating of *fail*.

**.111** A broad understanding of the peer review process, from the review of submitted engagements to the decision making process of determining whether an item noted during an Engagement Review is a matter, finding, deficiency, or significant deficiency, is shown in exhibit B. The exhibit also illustrates the aggregation of these items, where those items are documented in the practice aids, and how they might affect the type of report issued.

**Exhibit B**



**.112** As described by exhibit B in paragraph .111, depending on the resolution of a matter and the process of aggregating and evaluating peer review results, a matter may develop into a finding. Findings will also be evaluated, and after considering their nature and relative importance, including whether they are material to the understanding of the report or financial statements or represent the omission of a critical procedure including documentation, may not get elevated to a deficiency. Alternatively, a matter may develop into a finding and get elevated to a deficiency. That deficiency may or may not be further elevated to a significant deficiency.

**.113** A matter is documented on a MFC form. If the matter, after further evaluation, gets elevated to a finding, but not a deficiency or significant deficiency, it is documented on a FFC form. The FFC form is a standalone document that includes the reviewer's recommendation and the reviewed firm's response regarding actions planned or taken and the timing of those actions by the firm. MFC and FFC forms are subject to review and oversight by the administering entity, who will evaluate the reviewed firm's FFC form responses for appropriateness and responsiveness (see paragraphs .141–.145). If the matter documented on the MFC form is instead elevated to a deficiency or significant deficiency, then it is communicated in the report itself, along with the reviewer's recommendation. The firm submits a letter of response regarding actions planned or taken and the timing of those actions by the firm, which is also evaluated for appropriateness and responsiveness (see paragraphs .139–.140).

**.114** In order to document the disposition of all the MFCs, the review captain completes a DMFC form. The DMFC form is part of the working papers and provides a trail of the disposition of the MFCs for the peer reviewer, administering entity, and individuals conducting technical reviews or oversight. All of the MFCs are identified on the DMFC form with an indication after each as to whether it was cleared, discussed with the firm, included on a specific FFC form (individually or combined with other MFCs), or included as a deficiency in a report with a peer review rating of *pass with deficiencies* or as a significant deficiency in a report with a peer review rating of *fail*.

**.115** A firm that has an Engagement Review should respond promptly to questions raised in the review, whether those questions are raised orally or in writing. The review captain will contact the firm, before issuing the final peer review report, to resolve questions raised during the peer review and to complete the MFC, DMFC, and FFC forms as applicable. In addition to discussing deficiencies or significant deficiencies and recommendations to be included in a report with a peer review rating of *pass with deficiencies* or *fail*, ordinarily, these should be discussed, along with the content of the letter of response, and agreed upon with the firm prior to the issuance of the final written report. The review captain should also communicate, if applicable, that the firm may be required to (1) take certain actions to correct the deficiencies or significant deficiencies noted in the report or (2) complete an implementation plan to address the findings noted on the FFC form(s). The review team should also discuss with the reviewed firm the implications of these steps on the acceptance and completion of the peer review and the reviewed firm's enrollment in the program. This is also the appropriate opportunity for providing suggestions to the firm that are not included in the report, FFC form(s), or MFC form(s).

### Addressing Disagreements Between the Reviewer and the Reviewed Firm

**.116** Disagreements may arise during attempts to resolve various issues. For instance, there could be a disagreement on the appropriate approach to performing or reporting in conformity with applicable professional standards, or the review team might not believe that the actions planned or taken by the firm, if any, are appropriate (for example, if the reviewed firm believes that it can continue to support a previously issued report and the review team continues to believe that there may be a failure to reach appro-

priate conclusions in the application of professional standards). Reviewers and reviewed firms should understand that professional judgment often becomes a part of the process and that each party has the right to challenge each other on an issue. Nevertheless, a disagreement during the resolution of an issue may persist in some circumstances. The reviewed firm and reviewer should consult with their administering entity and, if necessary, request that a panel of the administering entity's peer review committee members resolve the disagreement. The panel must reach a decision to resolve the disagreement. Any of the disagreeing parties may request an appeal by writing the board and explaining why he or she believes a review of the panel's decision is warranted. A panel formed by the board will review and consider the request and take further action pursuant to fair procedures that it has established.

## Reporting on Engagement Reviews

### Forming Conclusions on the Type of Report to Issue in an Engagement Review

#### *Engagement Review Report With a Peer Review Rating of Pass*

**.117** A report with a peer review rating of *pass* is issued when the reviewer concludes that nothing came to his or her attention that caused him or her to believe that the engagements submitted for review were not performed and reported on in conformity with applicable professional standards in all material respects. There are no deficiencies or significant deficiencies that affect the nature of the report and, therefore, the report does not contain any deficiencies, significant deficiencies, or recommendations. In the event of a scope limitation, a report with a peer review rating of *pass (with a scope limitation)* is issued.

#### *Engagement Review Report With a Peer Review Rating of Pass With Deficiencies*

**.118** A report with a peer review rating of *pass with deficiencies* is issued when at least one but not all of the engagements submitted for review contain a deficiency. In the event of a scope limitation, a report with a peer review rating of *pass with deficiencies (with a scope limitation)* is issued.

#### *Engagement Review Report With a Peer Review Rating of Fail*

**.119** A report with a peer review rating of *fail* is issued when the review captain concludes that, as a result of the deficiencies described in the report, the engagements submitted for review were not performed or reported on in conformity with applicable professional standards in all material respects. A report with a peer review rating of *fail* is issued when deficiencies are evident on all of the engagements submitted for review. The review captain should not expand scope beyond the original selection of engagements in an effort to change the conclusion from a peer review rating of *fail* in these circumstances. In the event of a scope limitation, a report with a peer review rating of *fail (with a scope limitation)* is issued.

### General

**.120** In an Engagement Review, the review captain should furnish the reviewed firm with a written report within 30 days of the review of engagements or by the firm's peer review due date, whichever is earlier. A report on a review performed by a firm is to be issued on the letterhead of the firm performing the review. A report by a review team formed by an association of CPA firms is to be issued on the letterhead of the firm of the review captain performing the review. Other reports are issued on the letterhead of the administering entity. The report in an Engagement Review ordinarily should be dated as of the date of the completion of the peer review procedures. See interpretations for guidance on notification requirements and submission of peer review documentation to the administering entity.

***Illustrations of Reports in an Engagement Review***

**.121** The standard form for a report with a peer review rating of *pass* is illustrated in appendix M, "Illustration of a Report with a Peer Review Rating of *Pass* in an Engagement Review." Illustrations of reports with a peer review rating of *pass with deficiencies* and *fail* are presented in appendixes N, "Illustration of a Report with a Peer Review Rating of *Pass with Deficiencies* in an Engagement Review," and P, "Illustration of a Report with a Peer Review Rating of *Fail* in an Engagement Review," respectively. Additional paragraphs included for scope limitations follow the illustrations for System Reviews with scope limitations (see appendixes D, G, and K).

**.122** The written report in an Engagement Review should:

*a.* State at the top of the report the title "Engagement Review Report."

*b.* State that the review captain reviewed selected accounting engagements of the firm and include the year-end covered by the peer review.

*c.* State that the 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.

*d.* State that 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 (even though this is an Engagement Review, the statement reflects the responsibility of the firm).

*e.* State that the reviewer's responsibility is to evaluate whether the engagements submitted for review were performed and reported on in conformity with applicable professional standards in all material respects.

*f.* State that an Engagement Review does not include reviewing the firm's system of quality control and compliance therewith and, accordingly, the reviewers express no opinion or any form of assurance on that system.

*g.* State that the nature, objectives, scope, limitations of, and procedures performed in an Engagement Review are described in the standards.

*h.* Include a URL to the AICPA website where the standards are located.

*i.* Identify the different peer review ratings that the firm could receive.

*j.* In a report with a peer review rating of *pass*, state:

- That nothing came to the review captain's attention that caused the review captain to believe that the engagements submitted for review were not performed and reported on in conformity with applicable professional standards in all material respects.

- At the end of the second paragraph, that therefore the firm has received a peer review rating of *pass*.

- In the event of a scope limitation, include an additional paragraph before the last paragraph that describes the relationship of the excluded engagement(s) to the reviewed firm's practice as a whole, the highest level of service and industry concentration, if any, of the engagement(s) excluded from the potential selection, and the effect of the exclusion on the scope and results of the peer review.

- Reports with a peer review rating of *pass* do not contain any findings, deficiencies, significant deficiencies, or recommendations.

*k.* In a report with a peer review rating of *pass with deficiencies*, [fn 12] state:

- That except for the deficiencies previously described, nothing came to the review captain's attention that caused the review captain to believe that the engagements submitted for review were not performed and reported on in conformity with applicable professional standards in all material respects.

- At the end of the last paragraph, that therefore the firm has received a peer review rating of *pass with deficiencies*.

- In the event of a scope limitation, include an additional paragraph before the deficiencies that describes the relationship of the excluded engagement(s) to the reviewed firm's practice as a whole, the highest level of service and industry concentration, if any, of the engagement(s) excluded from the potential selection, and the effect of the exclusion on the scope and results of the peer review.

*l.* In a report with a peer review rating of *fail*, state:

- That as a result of the deficiencies previously described, the review captain believes that the engagements submitted for review were not performed or reported on in conformity with applicable professional standards in all material respects.

- At the end of the last paragraph, that therefore the firm has received a peer review rating of *fail*.

- In the event of a scope limitation, include an additional paragraph before the significant deficiencies that describes the relationship of the excluded engagement(s) to the reviewed firm's practice as a whole, the highest level of service and industry concentration, if any, of the engagement(s) excluded from the potential selection, and the effect of the exclusion on the scope and results of the peer review.

*m.* Include, for reports with a peer review rating of *pass with deficiencies* or *fail*, descriptions of the deficiencies or significant deficiencies and the reviewing firm's recommendations (each of these should be numbered) (see interpretations).

---

[fn 12] See footnote 11.

*n.* Identify, for any deficiencies or significant deficiencies included in the report with a peer review rating of *pass with deficiencies* or *fail*, any that were also made in the report in the firm's previous peer review. However, if the specific types of reporting, presentation, disclosure, or documentation deficiencies or significant deficiencies are not substantially the same on the current review as on the prior review, the deficiencies or significant deficiencies would not be considered a repeat (see interpretations).

*o.* Identify the level of service for any deficiencies or significant deficiencies. If the deficiency or significant deficiency included in the report with a peer review rating of *pass with deficiencies* or *fail* is industry specific, also identify the industry.

**Firm Responses in an Engagement Review**

**.123** In an Engagement Review, if the firm receives a report with a peer review rating of *pass with deficiencies* or *fail*, the reviewed firm should respond in writing to the deficiencies or significant deficiencies and related recommendations identified in the report. The letter of response should be addressed to the administering entity's peer review committee and should describe the actions planned (including timing) or taken by the reviewed firm with respect to each deficiency in the report. The reviewed firm should submit a copy of the report, and its letter of response, to the administering entity within 30 days of the date it received the report from the review captain or by the firm's peer review due date, whichever date is earlier. Prior to submitting the letter of response to the administering entity, the reviewed firm should submit the response to the review captain for review, evaluation, and comment (see interpretations).

**.124** If the firm receives a report with a peer review rating of *pass* or *pass (with a scope limitation)*, a letter of response is not applicable, and the reviewed firm does not submit a copy of the report to the administering entity.

**.125** The reviewed firm should respond to all findings and related recommendations not rising to the level of a deficiency or significant deficiency on the related FFC forms. These responses should describe the plan the reviewed firm has implemented or will implement (including timing) with respect to each finding. The review captain should review and evaluate the responses on the FFC forms before they are submitted to the administering entity (see interpretations).

**.126** If, after a discussion with the review captain, the reviewed firm disagrees with one or more of the findings, deficiencies, or significant deficiencies, the reviewed firm should contact the administering entity for assistance in the matter (see paragraph .116). If the reviewed firm still disagrees with one or more of the findings, deficiencies, or significant deficiencies, its response on either the FFC form or in the letter of response, as applicable, should describe the reasons for such disagreement.

**.127** Illustrations of letters of responses by a reviewed firm to reports with a peer review rating of *pass with deficiencies* and *fail* are included in appendixes O, "Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Pass With Deficiencies* in an Engagement Review," and Q, "Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Fail* in an Engagement Review."

## Administering Peer Reviews

**.128** All peer reviews intended to meet the requirements of the program should be carried out in conformity with these standards under the supervision of a state CPA society, group of state CPA societies, the AICPA Peer Review Board's National PRC (see interpretations), or other entity (hereinafter, administer-

ing entity) approved by the board to administer peer reviews. This imposes an obligation on reviewed firms to facilitate completion of their peer reviews in compliance with the procedures established by the board, and to cooperate with the peer reviewer, administering entity, and the board in all matters related to the review, that could impact the firm's enrollment in the program.

**.129** Entities requesting to administer the program are required to complete and sign a Plan of Administration annually whereby the entity agrees to administer the program in compliance with these standards, interpretations, and other guidance established by the board. Upon receipt of the plans by the AICPA, including jurisdictions not requesting to administer the program for their state, the board annually approves the administering entities for all of the jurisdictions covered by the program.

**.130** This imposes an obligation on the administering entities to ensure that their staff, technical reviewers, committee members, and all others involved in the administration of the program and performance of peer reviews comply with these standards, interpretations, and other guidance established by the board. Administering entities shall also cooperate with the board in all matters related to the administration of the program. Failure to comply with these standards, interpretations, and other guidance may result in the revocation of the administering entity's plan by the board. If an administering entity refuses to cooperate or is found to be deficient in administering the program in compliance with these standards or with other guidance, the board may decide pursuant to fair procedures whether the administering entity's plan should be revoked or whether some other action should be taken.

**.131** Due to the volume of peer reviews, firms, reviewers, and other contributing factors, the board recognizes that administering entities, and in some situations firms and peer reviewers, may need the flexibility, in specific circumstances, to implement alternate methods of complying with the standards, interpretations, or guidance issued by the board. The board or its staff will consider reasonable requests from administering entities 'peer review committees on such matters. The comprehensiveness of the administering entity's oversight policies and procedures will be considered as well as such factors as whether the objectives of the standards, interpretations, or guidance would still be met. Administering entities must submit a request in writing to the board for approval prior to implementing alternative methods of complying with the standards, interpretations, or other guidance. This request should ordinarily be submitted in conjunction with the submission of its plan.

## Fulfilling Peer Review Committee and Report Acceptance Body Responsibilities

**.132** An administering entity appoints a peer review committee to oversee the administration, acceptance, and completion of peer reviews. The committee may decide to delegate a portion of the report acceptance function to report acceptance bodies (RABs), whose members may be, but are not required to be, members of the committee as well. Members of a committee or a RAB must meet minimum qualification requirements (see interpretations). It is ultimately the committee's responsibility to ensure that it (or a RAB on its behalf) considers the results of peer reviews it administers that are undertaken to meet the requirements of the program. The activities of the committee should be carried out in accordance with administrative procedures and guidance issued by the board. Committee members may not participate in any discussion or have any vote with respect to a reviewed firm if the member lacks independence or has a conflict of interest with the reviewing firm, the reviewer, or the reviewed firm.

**.133** The committee's report acceptance body responsibilities include, but are not limited to:

*a.* Ensuring that peer reviews are presented to an RAB in a timely manner, ordinarily within 120 days of the receipt of the working papers, peer review report, and letter of response, if applicable,

from the team captain or review captain, or within 60 days for Engagement Reviews meeting certain criteria (see paragraphs .137–.138).

*b.* Considering whether the review has been performed in accordance with these standards, interpretations, and related guidance materials.

*c.* Considering whether the report, and the response thereto, if applicable, are in accordance with these standards, interpretations, and related guidance materials, including an evaluation of the adequacy of the corrective actions the reviewed firm has represented that it has taken or will take in its letter of response.

*d.* Determining whether it should require any remedial, corrective actions related to the deficiencies or significant deficiencies noted in the peer review report, in addition to or in affirmation of those described by the reviewed firm in its letter of response. Examples of such corrective actions include, but are not limited to, requiring certain individuals to obtain specified kinds and specified amounts of CPE, requiring the firm to carry out more comprehensive monitoring procedures, or requiring it to engage another CPA to perform pre-issuance or post-issuance reviews of financial statements, reports, and accounting and audit documentation to attempt to strengthen the performance of the firm's personnel.

*e.* In relation to FFCs:

1. Considering whether FFC (and associated MFC and DMFC) forms are prepared in accordance with these standards, interpretations, and related guidance materials, including whether the findings addressed on the FFC forms should have been included in a report with a peer review rating of *pass with deficiencies* or *fail*.

2. Determining the adequacy of the plan the reviewed firm has represented that it has implemented or will implement in its response on the FFC form(s).

3. Determining whether it should require an implementation plan in addition to or as an affirmation of the plan described by the reviewed firm in its response to the findings on the FFC form(s).

*f.* Ensuring that all corrective actions related to deficiencies or significant deficiencies in the peer review report and all implementation plans related to findings on FFC forms have been completed to the satisfaction of the committee.

*g.* Ensuring that all firms within its jurisdiction have timely peer reviews and keeping track of the timing of the completion of corrective actions and implementation plans by all firms that the committee has required, including those that are overdue.

**.134** In reaching its conclusions on the preceding items, the committee is authorized to make whatever inquiries or initiate whatever actions it considers necessary in the circumstances, including but not limited to requesting expansion of scope, revisions to the report, or the reviewed firm's response thereto. Such inquiries or actions by the committee should be made with the understanding that the program is intended to be positive and remedial in nature and is based on mutual trust and cooperation.

**.135** In the rare event of a disagreement between the administering entity and either the reviewer or the reviewed firm that cannot be resolved by ordinary good-faith efforts, the administering entity may request

that the matter be referred to the board for final resolution. Only the approved administering entity's peer review committee will be responsible for determining whether a disagreement still exists in order to refer the matter to the board. In these circumstances, the board may consult with representatives of other AICPA committees or with appropriate AICPA staff.

## Accepting System and Engagement Reviews

**.136** Technical reviews are required to be performed by the administering entity on all peer reviews. Technical reviewers must meet minimum qualification requirements (see interpretations).

**.137** All System Reviews are required to be presented for committee consideration, but committee consideration is not always required in an Engagement Review. The technical reviewer [fn 13] should be delegated the authority from the committee to accept Engagement Reviews in certain circumstances (see interpretations).

**.138** Engagement Reviews that do not require committee consideration are required to be accepted by the technical reviewer within 60 days of receipt of the working papers and report from the review captain. If the committee does not delegate the authority to the technical reviewer to accept Engagement Reviews under the specific criteria indicated previously, the review is required to be presented to the committee within 60 days of receipt of the working papers and report from the review captain.

**.139** In deciding on the need for and nature of any corrective actions, the committee should consider the nature and significance (and for System Reviews, the causes, pattern, pervasiveness, and relative importance to the system of quality control as a whole) of the deficiencies or significant deficiencies. It should evaluate whether the recommendations of the review team appear to address those deficiencies or significant deficiencies adequately and whether the reviewed firm's responses to those recommendations appear comprehensive, genuine, and feasible.

**.140** If the peer review committee determines that corrective actions related to the deficiencies or significant deficiencies noted in the peer review report, in addition or as an affirmation of those described by the firm in its letter of response, are appropriate, the firm will be required to evidence its agreement to perform these corrective action(s) in writing before the report is accepted and complete the action(s) as a condition of cooperation with the administering entity and the board.

## Cooperating in a Peer Review

**.141** Paragraph .05(*h*) of the standards noted that firms (and individuals) enrolled in the program have the responsibility to cooperate with the peer reviewer, administering entity, and the board in all matters related to the peer review, that could impact the firm's enrollment in the program, including taking remedial, corrective actions or implementing FFC plans as needed.

**.142** In deciding on the need for and nature of any implementation plan in addition to that described by the firm in its response on the FFC form, the committee should consider the nature and significance (and for

---

[fn 13] The responsibilities and the role of technical reviewers are included in the AICPA Peer Review Program Report Acceptance Body Handbook, which is provided to all administering entities.

System Reviews, the causes, pattern, pervasiveness, and relative importance to the system of quality control as a whole) of the findings. It should evaluate whether the recommendations of the review team appear to address those findings adequately and whether the reviewed firm's responses to those recommendations appear comprehensive, genuine, and feasible.

**.143** If the peer review committee determines, as part of its deliberations regarding the peer review, that an implementation plan in addition to or as an affirmation of those described by the firm in its responses on the FFC form are warranted, the firm will be required to evidence its agreement to perform this FFC implementation plan in writing and complete the plan as a condition of cooperation with the administering entity and the board (see interpretations). Although agreeing to and completing such a plan is not tied to the acceptance of the peer review, if a firm fails to cooperate, the firm would be subject to fair procedures that could result in the firm's enrollment in the program being terminated (see interpretations). The resulting MFC, DMFC, and FFC forms, as well as any correspondence relating to the implementation plan to be followed by the firm related to these documents, are outside of the reporting and acceptance process.

**.144** If a reviewed firm refuses to cooperate, fails to correct deficiencies or significant deficiencies, or is found to be so seriously deficient in its performance that education and remedial, corrective actions or implementation plans are not adequate, the board may decide, pursuant to fair procedures that it has established, to appoint a hearing panel to consider whether the firm's enrollment in the program should be terminated or whether some other action should be taken. A firm that receives peer reviews with recurring deficiencies or significant deficiencies that are not corrected may be deemed as a firm refusing to cooperate. In addition, a firm that fails to correct deficiencies or significant deficiencies after consecutive corrective actions requested by the committee may also be deemed as a firm refusing to cooperate.

**.145** If a decision is made by the hearing panel to terminate a firm's enrollment in the program, the firm will have the right to appeal to the AICPA Joint Trial Board for a review of the hearing panel's findings. The fact that a firm's enrollment in the program has been terminated shall be published in such form and manner as the AICPA Council may prescribe.

## Publicizing Peer Review Information

**.146** The reviewed firm should not publicize the results of the review or distribute copies of the peer review report to its personnel, clients, or others until it has been advised that the report has been accepted (see interpretations) by the administering entity as meeting the requirements of the program. Neither the administering entity nor the AICPA shall make the results of the review, or information related to the acceptance or completion of the review, available to the public, except as authorized or permitted by the firm under certain circumstances (see interpretations). The administering entity and the AICPA may disclose the following information:

*a.* The firm's name and address

*b.* The firm's enrollment in the program

*c.* The date of acceptance and the period covered by the firm's most recently accepted peer review

*d.* If applicable, whether the firm's enrollment in the program has been dropped or terminated

## Peer Reviewers' Performance and Cooperation

**.147** A team captain, review captain, or reviewer (hereinafter, reviewer) has a responsibility to perform a review in a timely, professional manner. This relates not only to the initial submission of the report and materials on the review, but also to the timely completion of any additional actions necessary to complete the review, such as completing any omitted documentation of the work performed on the review and resolving questions raised by the committee or technical reviewer accepting the review as well as the board and AICPA staff.

**.148** In considering peer review documents for acceptance, the committee evaluates the reviewer's performance on the peer review. In addition to the committee's evaluation, the board and AICPA staff also evaluate and track reviewers' performance on peer reviews. If a pattern of reviewer performance findings [fn 14] by a particular reviewer is noted, then the board or committee should issue a performance deficiency letter requiring the reviewer to complete one or more corrective actions or recommend to the board that the reviewer be prohibited from performing peer reviews in the future. If more than one reviewer performance deficiency [fn 15] is noted (regardless of whether a pattern is present), then the board or committee should either issue a performance deficiency letter requiring the reviewer to complete one or more corrective actions or recommend to the board that the reviewer be prohibited from performing peer reviews in the future.

**.149** In situations in which one or more of such corrective actions are required, the administering entity must inform AICPA staff and such actions will be recognized by all other administering entities. Any corrective action required of a reviewer will apply to the individual's participation in the performance of any peer review unless the condition is specific to the individual's service as only a team captain, review captain, team member, or QCM reviewer.

**.150** If the reviewer disagrees with the corrective action(s) required by the committee or board, he or she may appeal the decision by writing the board and explaining why he or she believes that the action(s) are unwarranted. A hearing panel formed by the board will review and consider the request and take further action pursuant to fair procedures that it has established.

**.151** If a reviewer fails to correct reviewer performance deficiencies after a corrective action has been required or has committed egregious acts [fn 16] in the performance of a peer review, the committee should recommend to the board that the reviewer be prohibited from performing peer reviews in the future.

**.152** When a committee recommends that a reviewer should be prohibited from performing peer reviews in the future, the board shall appoint a hearing panel to consider, pursuant to fair procedures that it has established, whether the reviewer should be removed from the list of qualified reviewers or whether some other action should be taken. The board may appoint such a hearing panel without a committee recom-

---

[fn 14] These terms are defined in the AICPA Peer Review Program Report Acceptance Body Handbook.

[fn 15] These terms are defined in the AICPA Peer Review Program Report Acceptance Body Handbook.

[fn 16] These terms are defined in the AICPA Peer Review Program Report Acceptance Body Handbook.

mendation. If the reviewer disagrees with the decision of the panel, he or she may appeal the decision by writing the board and explaining why he or she believes removal from the list of qualified reviewers is unwarranted. The board will take further action pursuant to fair procedures that it has established.

**.153** If a reviewer has a corrective or other action(s) imposed on him or her by the committee or board, and the reviewer had previously been approved to perform a peer review that has either begun or has yet to begin, then the committee or board will need to consider whether the review should be performed by another reviewer, or if the review should be overseen by a member of the committee at the reviewer's expense, or other actions, if any (whether or not the reviewer has filed an appeal with the board). If the reviewer has completed the fieldwork on one or more peer reviews prior to the imposition of the corrective action, then the committee or board will consider what action, if any, to take regarding those peer reviews based on the facts and circumstances.

## Performing and Reporting on Reviews of Quality Control Materials (QCM)

### Introduction

**.154** Quality control materials (QCM) are materials that are suitable for adoption by a firm as an integral part of that firm's system of quality control. Such materials provide guidance to assist firms in performing and reporting in conformity with professional standards and may include, but are not limited to, such items as engagement aids, including accounting and auditing manuals, checklists, questionnaires, work programs, computer-aided accounting and auditing tools, and similar materials intended for use by accounting and auditing engagement teams.

**.155** Organizations (hereinafter referred to as *providers*) may sell or otherwise distribute to CPA firms (hereinafter referred to as *user firms*) QCM that they have developed.

**.156** Providers may elect voluntarily or be required to have an independent review of their system of quality control for the development and maintenance of the QCM they have developed, and of the resultant materials (see paragraph .159). The reasons for having such a review are:

*a.* Providing reasonable assurance to user firms that the provider's system of quality control to develop and maintain QCM is appropriately designed and complied with, and that the resultant materials are reliable aids to assist them in conforming with all those components which are integral to the professional standards the materials purport to encompass.

*b.* Providing more cost-effective peer reviews for firms that use such materials by allowing the peer reviewers of user firms to place reliance on the results of the QCM review in evaluating the design of the user firm's system of quality control.

*c.* Ensuring that independence and objectivity on peer reviews of user firms is maintained when such peer reviews are performed by providers.

**.157** A summary of the nature, objectives, scope, limitations of, and procedures performed on QCM reviews is included in appendix A.

### Objectives of a QCM Review

**.158** The objectives of a review of QCM developed by a provider are determining:

*a.* Whether the provider's system for the development and maintenance of the QCM was suitably designed and was being complied with during the period under review to provide user firms with reasonable assurance that the materials are reliable aids.

*b.* Whether the resultant materials are reliable aids to assist user firms in conforming with all those components which are integral to the professional standards the materials purport to encompass.

**Applicability**

**.159** Generally, there are two categories of providers:

*a.* A CPA firm or its affiliate or related entity (see interpretations) that develops and maintains QCM (collectively, a provider firm). A provider firm is ordinarily permitted to perform the peer review of a user firm if an independent review of both the provider firm's system of quality control for the development and maintenance of the QCM and the provider firm's resultant materials (the QCM review) is performed as a safeguard of independence.

*b.* Any other type of organization that does not fall under the description of a provider firm (voluntary provider), including an association of CPA firms providing QCM or a third party organization that provides QCM as a primary function of its business.

All QCM reviews are administered by the National PRC and performed in accordance with these standards.

**.160** With respect to a provider firm, the initial QCM review is due within six months of the elected year-end date. The initial QCM review is required to be completed before the provider firm can be scheduled to perform the peer review of a user firm. A provider firm's subsequent QCM review has a due date of three years and six months from the year-end of the previous QCM review. The due date for a QCM review is the date by which the QCM review report, letter of response (if applicable), and the QCM reviewer's working papers are to be submitted to the National PRC. If the QCM review working papers are not submitted by the due date, the provider firm will no longer be independent to perform peer reviews of user firms after that date (that is, the necessary independence safeguard was not implemented timely, which is considered noncooperation).

**.161** Subsequent to the QCM review, if there are substantial changes in either the system for the development and maintenance of the materials or in the resultant materials themselves, the provider firm should consult with the National PRC to determine whether an accelerated QCM review is required.

**.162** In addition, a provider firm that will perform the peer review of a user firm is required to have its own firm's subsequent peer reviews administered by the National PRC (from the point of scheduling the QCM review onward) (see interpretations).

**.163** Voluntary providers of QCM that elect (but are not required) to have a QCM review should consult with the National PRC. Reviews of providers that voluntarily elect to have a QCM review under these standards must comply with the standards in all respects.

**.164** Materials relating to the PCAOB standards are not within the scope of these standards.

**.165** The National PRC will administer reviews of QCM based on the standards and the RAB Handbook. When not otherwise addressed in this section, QCM reviewers and providers should refer to the other

sections of the Standards for Performing and Reporting on Peer Reviews for additional guidance on performing, reporting on, and accepting QCM reviews.

**Qualifications for Serving as a QCM Reviewer**

**.166** The National PRC establishes minimum requirements to qualify as a QCM reviewer. In addition to the peer reviewer qualifications set forth in the paragraphs under "Organizing the System or Engagement Review Team" and "Qualifying for Service as a Peer Reviewer" (see paragraphs .26–.35) and in the interpretations, the National PRC will consider other factors in determining whether a potential QCM reviewer is qualified (see interpretations). Members of the QCM review team must be approved by the National PRC prior to the commencement of the review. Final approval of QCM review teams is at the National PRC's discretion.

**Procedures for Planning and Performing QCM Reviews**

**.167** A QCM review should include procedures to plan and perform the review. The provider should identify the specific materials subject to the QCM review that will be opined upon in the report. Procedures to test the provider's system of quality control should be determined based on the specific materials included in the scope of the review.

**.168** Once materials are identified for review purposes, they cannot be subsequently excluded from the scope of the review without resulting in a scope limitation. If the QCM review is required because the provider firm plans to peer review user firms, ordinarily all of the provider firm's materials should be included in the scope of the QCM review. If specific materials are excluded from the scope of the QCM review, then the provider firm will not be independent of firms that use those specific materials excluded from the scope of the QCM review.

***Planning Considerations***

**.169** The QCM reviewer should obtain the prior QCM report, the letter of response (if applicable), and the acceptance letter from the provider. The QCM reviewer should also obtain the prior FFC forms (if applicable) from the National PRC. The QCM reviewer should consider whether the issues discussed in those documents require additional emphasis in the current review, and evaluate the provider's actions in response to the prior report.

**.170** In addition, the QCM review team should assess the risk associated with QCM reviews. This is the risk that the QCM review team:

*a.* Fails to identify significant weaknesses in the provider's system of quality control for the development and maintenance of its quality control materials, its lack of compliance with that system, or a combination thereof.

*b.* Fails to identify significant weaknesses in the materials.

*c.* Issues an inappropriate opinion on the provider's system of quality control for the development and maintenance of its quality control materials, its compliance with that system, or a combination thereof.

*d.* Issues an inappropriate opinion on the materials.

*e.* Reaches an inappropriate decision about the matters to be included in, or excluded from, the report.

**.171** QCM review risk consists of:

*a.* The risk (consisting of inherent risk and control risk) that the quality control materials are not reliable aids, that the provider's system of quality control will not prevent such failure, or both.

*b.* The risk (detection risk) that the review team will fail to detect and report on design or compliance deficiencies or significant deficiencies in the provider's system of quality control or in the resultant materials.

**.172** In planning the review, the QCM review team should assess and document the relevant inherent and control risk factors, and how the combined risks affect detection risk and, therefore, the scope of review procedures. This assessment should include but is not limited to consideration of the nature and environment of the provider (including economic and competitive pressures); experience with developing and maintaining QCM; the level of risk; complexity and change inherent in the industries and professional standards covered by the QCM; prior findings on previously-issued materials and the disposition of those findings; and any investigations, allegations, or restrictions on authors and technical reviewers (including outside and guest authors or technical reviewers).

***Understanding the Provider's System of Quality Control***

**.173** A provider's system of quality control for the development and maintenance of the materials normally should include:

*a.* A requirement that the provider's system of quality control be documented.

*b.* A requirement that the provider perform on-going monitoring of its system of quality control.

*c.* A requirement that the materials be developed and maintained by individuals qualified in the subject matter.

*d.* A requirement that the materials be reviewed for technical accuracy by a qualified person(s) other than the developer(s).

*e.* Procedures to ensure that the individuals who develop, maintain, or review the materials for technical accuracy are appropriately qualified in the subject matter.

*f.* Procedures to ensure that the materials are current and address the relevant professional standards and industry guidance.

*g.* Procedures for soliciting and evaluating feedback from users of the materials.

*h.* Procedures for communicating the period and, where appropriate, the professional standards encompassed by the materials.

*i.* Procedures (if any) regarding the issuance of updates to the materials and, if a policy exists, the method of updating. If the provider's policy is not to provide updates to the materials between versions, then include the procedures for communicating this policy to users.

*j.* Procedures for ensuring that the materials are updated in accordance with the provider's policy when it has undertaken to update them.

*k.* Procedures for ensuring that the system of quality control as designed is operating effectively.

**.174** A study and evaluation of the system for the development and maintenance of the materials normally should include the following procedures:

*a.* Reviewing and evaluating the procedures established for monitoring the system of quality control, and assessing how any findings or issues were resolved.

*b.* Reviewing and evaluating the procedures established for developing and maintaining the materials.

*c.* Reviewing and evaluating the procedures established for updating (including distributing) the materials to ensure that the materials remain current and relevant when the provider has undertaken the responsibility for updating the materials.

*d.* Reviewing the technical competence of the developers and updaters (if applicable) of the materials.

*e.* Obtaining evidence that the materials were reviewed for technical accuracy by qualified person(s) other than the developers or updaters.

*f.* Determining whether the provider has appropriately communicated its policy regarding the period covered by the materials, the professional standards the materials purport to encompass, and the provider's policy regarding updating the materials.

*g.* Reviewing the system developed for soliciting and evaluating feedback from users of the materials.

***Performing Tests of the Materials***

**.175** The scope of the QCM review includes all of the materials identified by the provider and covered in the opinion (see paragraph .167). The extent to which individual manuals, guides, checklists, practice aids, and so on are reviewed is subject to the QCM review team's judgment and should be documented in the risk assessment (see interpretations). For QCM reviews of provider firms, all materials should be within the scope of the review. A QCM review team should review the resultant materials, to the extent deemed necessary, to evaluate whether the materials are reliable aids to assist user firms in conforming with all those components which are integral to the professional standards the materials purport to encompass.

**.176** For all of the materials tested, the QCM review team should assess whether or not the materials are reliable aids. This includes evaluating whether the materials can assist users in conforming with all those components which are integral to the professional standards that the materials purport to encompass. The QCM review team performs this evaluation by assessing the level of instructions and explanatory guidance in the materials, and determining whether the methodology inherent in the materials is appropriate (see interpretations).

**Identifying Matters, Findings, Deficiencies, and Significant Deficiencies**

**.177** In evaluating the provider's system of quality control, the QCM review team may note that the system is not appropriately designed or complied with. Similarly, the tests of the provider's materials may uncover that design weaknesses or lack of compliance with the system resulted in one or more materials that do not reach the threshold of reliable aids. With any of these items, the QCM review team has available a set of definitions to assist in classifying the condition noted.

**.178** Determining the relative importance of matters noted during the QCM review, individually or combined with others, requires professional judgment. Careful consideration is required in forming conclusions. The descriptions that follow are intended to assist in aggregating and evaluating the QCM review results, concluding on them, and determining the nature of the QCM review report to issue:

*a.* A *matter* is noted as a result of

i. the QCM reviewer's evaluation of the design of and compliance with the provider's system of quality control. Matters can be one or more "no" answers to questions in QCM review questionnaire(s) that a QCM reviewer concludes warrants further consideration in the evaluation of a provider's system of quality control.

ii. the QCM reviewer's evaluation of whether the materials submitted for review are reliable aids. Matters can arise from either the QCM reviewer's comments based on tests of the materials, or one or more "no" answers to questions in QCM review questionnaire(s) that the QCM reviewer concludes warrants further consideration by the provider in the evaluation of the materials.

A matter is documented on a MFC form.

*b.* A *finding* is one or more matters that result from

i. a condition in the provider's system of quality control or compliance with it such that there is more than a remote possibility that the provider would not develop or maintain reliable aids, or

ii. the QCM reviewer's conclusion that one or more of the materials tested do not encompass some portion of the components of the professional standards that the materials purport to encompass.

A QCM reviewer will conclude whether one or more findings are a deficiency or significant deficiency. If the QCM reviewer concludes that no finding, individually or combined with others, rises to the level of deficiency or significant deficiency, a report rating of *pass* is appropriate. A finding not rising to the level of a deficiency or significant deficiency is documented on a FFC form.

*c.* A *deficiency* is one or more findings that

i. the QCM reviewer has concluded, due to the nature, causes, pattern, or pervasiveness, could create a situation in which the provider would not have reasonable assurance of developing or maintaining reliable aids, or

ii. affects the reliability of one or more of the materials tested, such that one or more of the materials do not encompass the components which are integral to the professional standards that the materials purport to encompass.

This includes the relative importance of the deficiency to either the provider's system of quality control taken as a whole, or any of the materials tested (individually or collectively). It is not a significant deficiency if the QCM reviewer has concluded that except for the deficiency or deficiencies the provider has reasonable assurance of developing and maintaining reliable aids or that the nature of the deficiency or deficiencies is limited to a small number of the total materials reviewed. Such deficiencies are communicated in a report with a QCM review rating of *pass with deficiencies*.

*d.* A *significant deficiency* is one or more deficiencies that the QCM reviewer has concluded results from a condition in the provider's system of quality control when the system taken as a whole does not provide reasonable assurance of developing or maintaining reliable aids, and it has affected the reliability of one or more of the materials reviewed.

Such deficiencies are communicated in a report with a QCM rating of *fail*.

**Aggregating and Evaluating Matters in the Provider's System**

**.179** The QCM review team must aggregate matters noted during the review of the provider's system of quality control to develop and maintain the materials in order to conclude on the opinion of the provider's system. This entails determining whether any matters noted were the result of the design of the provider's system of quality control or the failure of its personnel to comply with the provider's quality control policies and procedures. The QCM review team should consider their relative importance to both the provider's system of quality control as a whole and the impact on the materials (individually and collectively), and their nature, causes, pattern, and pervasiveness.

**.180** The use of professional judgment is essential in determining whether matters should be aggregated as findings, and whether one or more findings is a deficiency or significant deficiency.

***Design Matters***

**.181** A design matter in a QCM review exists when the provider's system of quality control is missing a quality control policy or procedure or when the provider's existing quality control policies and procedures (even if fully complied with) would not result in the development or maintenance of reliable aids in one or more respects. To be effective, a system of quality control must be designed properly, and all of the quality control policies and procedures necessary to provide the provider with reasonable assurance of developing and maintaining reliable aids should be in place. Therefore, the QCM review team will need to determine whether the quality control policies and procedures would be effective if they were complied with. To make this determination, the QCM review team should consider the implications of the evidence obtained during its evaluation of the system of quality control and its tests of compliance, including its review of the materials.

**.182** The relative importance of design matters noted in the provider's quality control policies and procedures, individually and in the aggregate, need to be evaluated in the context of the provider's organizational structure, the nature of its practice, the number of users, and so on. For example, a matter noted during the review of a quality control policy or procedure may be partially or wholly offset by another policy or procedure. In this circumstance, the QCM review team should consider the interrelationships among the elements of quality control and weigh the matters noted against compensating policies and procedures to determine whether a finding exists and its relative importance.

**.183** There may be circumstances in which the QCM reviewer finds few findings in the materials developed and maintained by the provider, yet he or she still concludes that the design of the provider's system of quality control needs to be improved. For example, a provider that has a rapidly growing customer base may not have appropriately revised its policies and procedures to solicit user feedback. However, this type of finding may not result in less than reasonable assurance of developing or maintaining reliable aids. The QCM reviewer should exercise judgment in determining whether this matter should be addressed in a FFC as a finding rather than result in a report with a QCM review rating of *pass with deficiencies* or *fail.*

***Compliance Matters***

**.184** A compliance matter exists when a properly designed quality control policy or procedure does not operate as designed because of the failure of the personnel of the provider to comply with it. Because a variance in individual performance will affect the degree of compliance, adherence to all policies and procedures in every case generally is not possible. However, the degree of compliance by the personnel of the provider with its prescribed quality control policies and procedures should be adequate to give the provider reasonable assurance of developing and maintaining reliable aids.

**.185** In assessing whether the degree of compliance was adequate to provide the required assurance, the QCM review team should consider the nature, causes, pattern, and pervasiveness of the instances of noncompliance noted and their relative importance to the provider's system of quality control as a whole, as well as their importance in the specific circumstances in which they were observed. As with the evaluation of design matters, compliance matters also need to be evaluated in the context of the provider's organizational structure, the nature of its practice, the number of users, and so on.

**.186** To determine the degree of noncompliance, the QCM review team should evaluate the matters of noncompliance, both individually and in the aggregate, recognizing that adherence to certain policies and procedures of the provider is more critical to the provider obtaining reasonable assurance of developing and maintaining reliable aids. In this context, the QCM review team should consider the likelihood that noncompliance with a given quality control policy or procedure could have resulted in materials that are not reliable aids. The more direct the relationship between a specific quality control policy or procedure and the reliability of the aids, the lower the degree of noncompliance necessary to determine whether a matter (or matters) is a finding and whether a finding is a deficiency or significant deficiency.

**Aggregating and Evaluating Matters in the Provider's Materials**

**.187** The QCM review team must also aggregate matters noted during the QCM review in order to conclude on the separate opinion on the reliability of the materials. Any design or compliance matters will usually be addressed in the consideration of the provider's system. However, all matters that impact the system also have to be evaluated for their impact and relative importance on the individual materials reviewed and opined upon in the report. The use of professional judgment is essential in determining whether matters should be aggregated as findings, and whether one or more findings is a deficiency. One or more deficiencies in the materials is indicative of a deficiency or significant deficiency in the provider's system of quality control.

**.188** The QCM review team should consider whether design matters noted in the review of the provider's quality control system, individually and in the aggregate, impact the reliability of the materials. For example, a provider may not specify in its policies and procedures that authors must have a certain level of professional experience or expertise. In this circumstance, the QCM review team should consider whether this design matter resulted in a potentially inexperienced or otherwise unqualified author writ-

ing portions of the materials, and whether those portions of the materials are technically accurate, to determine the impact on the reliability of the materials, and whether a finding or deficiency exists with respect to the materials.

**.189** Similarly, the QCM review team should consider whether compliance matters noted in either the review of the provider's quality control system or in the tests of the materials impact the reliability of the aids. For example, personnel that performed technical review on a particular industry manual may not have obtained the appropriate type or amount of CPE for that industry in compliance with the provider's policies and procedures. In this circumstance, the QCM review team should consider if this compliance matter resulted in a failure to include new or recent changes in professional standards or industry guidance, or other omissions, to determine whether a finding or deficiency exists with respect to the materials.

## Reporting on QCM Reviews

### *General*

**.190** The QCM review team should furnish the provider with a written report and the final FFC forms within 30 days of the date of the exit conference or by the provider's review due date, whichever is earlier. A report on a QCM review performed by a firm is to be issued on the letterhead of the firm performing the review. A report by a QCM review team formed by an association of CPA firms is to be issued on the letterhead of the firm of the team captain performing the review. The report in a QCM review ordinarily should be dated as of the date of the exit conference. See interpretations for guidance on notification requirements and submission of peer review documentation to the administering entity.

### *Forming Conclusions on the Type of Report to Issue in a QCM Review*

**.191** The following circumstances ordinarily would be considered deficiencies or significant deficiencies:

*a.* The scope of the review is limited by conditions that preclude the application of one or more review procedures considered necessary (that is, a scope limitation).

*b.* The provider's system of quality control for the development and maintenance of QCM, as designed, did not provide reasonable assurance that reliable aids had been developed or maintained.

*c.* The degree of compliance with the provider's system of quality control for the development and maintenance of QCM was not sufficient to provide user firms with reasonable assurance that reliable aids had been developed or maintained.

*d.* The resultant QCM are not reliable aids to assist user firms in conforming with the components integral to the professional standards the materials purport to encompass (generally resulting from the condition described in *b* or *c*).

**.192** In those instances in which the QCM review team determines that a report with a review rating of *pass with deficiencies* or *fail* is required, all the reasons should be disclosed, and the QCM review team should consult with the National PRC prior to the issuance of the report.

### *Preparing the Report in a QCM Review*

**.193** The standard forms for a QCM review report with a review rating of *pass*, *pass with deficiencies*, and *fail* are included in appendixes R, "Illustration of a Report With a Review Rating of *Pass* in a Review of Quality Control Materials;" S, "Illustration of a Report with a Review Rating of *Pass with Deficiencies*

in a Review of Quality Control Materials;" and T, "Illustration of a Report with a Review Rating of *Fail* in a Review of Quality Control Materials," respectively.

**.194** A QCM report with a rating of *pass*, *pass with deficiencies*, or *fail* contains elements similar to those in a System Review report. As such, the written report in a QCM System Review should:

*a.* State at the top of the page the title "Quality Control Materials Review Report."

*b.* State that the system of quality control for the development and maintenance of the materials and the resultant materials in effect at the year-end covered by the QCM review were reviewed.

*c.* State that the 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.

*d.* State that the provider is responsible for designing a system of quality control and complying with it to provide users of the materials with reasonable assurance that the materials are reliable aids to assist them in performing and reporting in conformity with the components which are integral to the professional standards that the materials purport to encompass.

*e.* State that the reviewer's responsibility is to express an opinion on the design of the system of quality control, the provider's compliance with that system, and the reliability of the resultant materials based on the review.

*f.* State that the nature, objectives, scope, limitations of, and procedures performed in a Quality Control Materials review are described in the standards.

*g.* Include a URL reference to the AICPA website where the standards are located.

*h.* State that the users of the materials are responsible for implementing, tailoring, and augmenting the materials as appropriate.

*i.* State that there may be important elements of a quality control system in accordance with Statements on Quality Control Standards that are not part of the materials that have been subject to this QCM review.

*j.* Identify the different peer review ratings that the provider could receive.

*k.* In a report with a peer review rating of *pass*:

- Express an opinion that the system of quality control for the development and maintenance of the quality control materials was suitably designed and was being complied with during the year ended to provide reasonable assurance that the materials are reliable aids.

- Express an opinion that the quality control materials were reliable aids to assist users in conforming with the components which are integral to the professional standards the materials purport to encompass at year-end.

- State at the end of the opinion paragraph that therefore the report reflects a peer review rating of *pass*.

- Reports with a peer review rating of *pass* do not contain any findings, deficiencies, significant deficiencies, or recommendations.

*l.* In a report with a review rating of *pass with deficiencies*: [fn 17]

- Express an opinion that, except for the deficiencies described previously, the system of quality control for the development and maintenance of the quality control materials was suitably designed and was being complied with during the year ended to provide reasonable assurance that the materials are reliable aids or

- Express an opinion that, except for the deficiencies described previously, the quality control materials were reliable aids to assist users in conforming with the components which are integral to the professional standards the materials purport to encompass at year-end.

- State at the end of the opinion paragraph that therefore the report reflects a review rating of *pass with deficiencies*.

*m.* In a report with a peer review rating of *fail*:

- Express an opinion that as a result of the significant deficiencies described previously, the system of quality control for the development and maintenance of the quality control materials was not suitably designed and being complied with during the year ended and, therefore, cannot provide reasonable assurance that the materials are reliable aids.

- Express an opinion that also, as a result of the significant deficiencies described previously, the quality control materials are not reliable aids and do not assist users in conforming with the components which are integral to the professional standards the materials purport to encompass at year-end.

- State at the end of the opinion paragraph that therefore the provider has received a peer review rating of *fail*.

*n.* Include, for reports with a review rating of *pass with deficiencies* or *fail*, written descriptions of the deficiencies or significant deficiencies and the reviewing firm's recommendations (each of these should be numbered).

*o.* Identify, for any deficiencies or significant deficiencies included in the report with a review rating of *pass with deficiencies* or *fail* any that were also made in the report issued on the provider's previous QCM review. This should be determined based on the underlying systemic cause of the deficiencies or significant deficiencies.

**Provider Responses on QCM Reviews**

---

[fn 17] See footnote 11.

**.195** If the provider receives a report with a review rating of *pass with deficiencies* or *fail*, then the provider should respond in writing to the deficiencies and significant deficiencies and related recommendations identified in the report, if applicable. The letter of response should be addressed to the National PRC and should describe the action(s) planned (including timing) or taken by the provider with respect to each deficiency in the report. If the provider disagrees with one or more of the deficiencies or significant deficiencies, its response should describe the reasons for such disagreement. In the event that a material error or omission in the materials is uncovered by the QCM review team, the response also should describe the provider's plan for notifying known users of that error or omission. The provider should submit the letter of response for review and comment to the QCM reviewer prior to submitting the response to the National PRC.

**.196** The provider should submit a copy of the report and its letter of response to the National PRC within 30 days of the date it received the report or by the provider's review due date, whichever date is earlier. Prior to submitting the response to the National PRC, the provider should submit the response to the QCM reviewer for review, evaluation, and comment. If the provider receives a report with a review rating of *pass*, a letter of response is not applicable, and the provider does not submit a copy of the report to the National PRC.

**.197** The provider should also respond on the FFC forms, if any are developed, to findings and related recommendations. These responses should describe the plan (including timing) the provider has implemented or will implement with respect to each finding. They should be submitted to the QCM reviewer no later than two weeks after the exit conference or by the review's due date, whichever is earlier. FFC forms are submitted by the QCM reviewer with the applicable working papers to the National PRC.

**.198** If, after a discussion with the QCM reviewer, the provider disagrees with one or more of the findings, deficiencies, or significant deficiencies, the provider should contact the National PRC for assistance in the matter (see paragraph .93). If the provider still disagrees with one or more of the findings, deficiencies, or significant deficiencies, its response on either the FFC form or in the letter of response, as applicable, should describe the reasons for such disagreement.

### Cooperating in a QCM Review

**.199** Providers that undertake to have a QCM review under these standards have a responsibility to cooperate with the QCM review team, the National PRC, and the board in all matters related to the QCM review.

**.200** If a provider firm fails to cooperate during the course of a QCM review, the provider firm's independence with respect to user firms may be impaired (see interpretations).

### QCM Reviewers' Performance and Cooperation

**.201** A QCM reviewer has a responsibility to perform a QCM review in a timely, professional manner. This relates not only to the initial submission of the report and materials on the review, but also to the timely completion of any additional actions necessary to complete the review, such as resolving questions raised by the National PRC, as well as the board and AICPA staff.

**.202** In considering QCM review documents for acceptance, the National PRC evaluates the QCM reviewer's performance on the QCM review. In addition to the National PRC's evaluation, the board and AICPA staff also evaluate and track reviewers 'performance on both peer reviews and QCM reviews.

**.203** If weaknesses in a QCM reviewer's performance are noted on a particular QCM review (for example, submitting incomplete review documentation, not performing sufficient review procedures, a failure to resolve questions raised by the committee or technical reviewer, and so on), or if the QCM reviewer refuses to cooperate with the National PRC at any time during the review process, the QCM reviewer will be required to comply with the actions described in paragraphs .148–.153. In addition, the National PRC has the discretion to no longer approve that individual to perform future QCM reviews or other peer reviews.

**Publicizing QCM Review Information**

**.204** The provider should not publicize the results of the review or distribute copies of the QCM report to its personnel, users, or others until it has been advised that the report has been accepted by the National PRC.

**.205** Providers that elect or are required to have a QCM review under these standards agree that the National PRC and the AICPA may disclose the following information to allow peer reviewers of user firms to easily obtain this information for consideration during the user firm's peer review:

*a.* The provider's name

*b.* The results of the QCM review (that is, report, letter of response (LOR) (if applicable), and so on)

*c.* The date of acceptance and the year covered by the provider's most recently accepted QCM review

## Effective Date

**.206** The effective date for these standards is for peer reviews commencing on or after January 1, 2009 and QCM reviews commencing on or after January 1, 2011. Early implementation is permitted for QCM reviews, but not for peer reviews.

## Appendix A

## Summary of the Nature, Objectives, Scope, Limitations of, and Procedures Performed in System and Engagement Reviews and Quality Control Materials Reviews (as Referred to in a Peer Review Report)

(Effective for Peer Reviews Commencing on or After January 1, 2009)

**.207**

1. Firms (and individuals) enrolled in the AICPA Peer Review Program are required to have a peer review, once every three years, of their accounting and auditing practice related to non-SEC issuers covering a one-year period. The peer review is conducted by an independent evaluator, known as a peer reviewer. The AICPA oversees the program, and the review is administered by an entity approved by the AICPA to perform that role.

2. The peer review helps to monitor a CPA firm's accounting and auditing practice (*practice monitoring*). The goal of the practice monitoring, and the program itself, is to promote quality in the account-

ing and auditing services provided by the AICPA members and their CPA firms. This goal serves the public interest and enhances the significance of AICPA membership.

3. There are two types of peer reviews: System Reviews and Engagement Reviews. System Reviews focus on a firm's system of quality control and Engagement Reviews focus on work performed on particular selected engagements. As noted in paragraphs .04 and .157, a further description of System and Engagement Reviews, and Quality Control Materials (QCM) Reviews, as well as a summary of the nature, objectives, scope, limitations of, and procedures performed on them, is provided in the following sections.

System Reviews

4. A System Review is a type of peer review that is a study and appraisal by an independent evaluator(s), known as a peer reviewer, of a CPA firm's system of quality control to perform accounting and auditing work. The system represents the policies and procedures that the CPA firm has designed, and is expected to follow, when performing its work. The peer reviewer's objective is to determine whether the system is designed to ensure conformity with professional standards and whether the firm is complying with its system appropriately.

5. Professional standards are literature, issued by various organizations, that contain the framework and rules that a CPA firm is expected to comply with when designing its system and when performing its work. Professional standards include but are not limited to the Statements on Quality Control Standards issued by the AICPA that pertain to leadership responsibilities for quality within the firm (the "tone at the top"); relevant ethical requirements (such as independence, integrity and objectivity); acceptance and continuance of client relationships and specific engagements; human resources; engagement performance; and monitoring.

6. To plan a System Review, a peer reviewer obtains an understanding of (1) the firm's accounting and auditing practice, such as the industries of its clients, and (2) the design of the firm's system, including its policies and procedures and how the firm checks itself that it is complying with them. The reviewer assesses the risk levels implicit within different aspects of the firm's practice and its system. The reviewer obtains this understanding through inquiry of firm personnel and review of documentation on the system, such as firm manuals.

7. Based on the types of engagements firms perform, they may also have their practices reviewed or inspected on a periodic basis by regulatory or governmental entities, including but not limited to the Department of Health and Human Service, the Department of Labor, and the PCAOB. The team captain obtains an understanding of those reviews or inspections, and he or she considers their impact on the nature and extent of the peer review procedures performed.

8. Based on the peer reviewer's planning procedures, the reviewer looks at a sample of the CPA firm's work, individually called engagements. The reviewer selects engagements for the period covered by the review from a cross section of the firm's practice with emphasis on higher risk engagements. The engagements selected include those performed under *Government Auditing Standards*, audits of employee benefit plans, audits of depository institutions (with assets of $500 million or greater), audits of carrying broker-dealers, and examinations of service organizations (Service Organization Control [SOC] 1® and SOC 2® engagements) when applicable. The scope of a peer review only covers accounting and auditing engagements performed under U.S. professional standards; it does not include the firm's SEC issuer practice, nor does it include tax or consulting services. The reviewer will also look at administra-

tive elements of the firm's practice to test the elements listed previously from the Statements on Quality Control Standards.

9. The reviewer examines engagement working paper files and reports, interviews selected firm personnel, reviews representations from the firm, and examines selected administrative and personnel files. The objectives of obtaining an understanding of the system and then testing the system forms the basis for the reviewer's conclusions in the peer review report.

10. When a CPA firm receives a report from the peer reviewer with a peer review rating of *pass*, the report means that the system is appropriately designed and being complied with by the CPA firm in all material respects. If a CPA firm receives a report with a peer review rating of *pass with deficiencies*, this means the system is designed and being complied with appropriately by the CPA firm in all material respects, except in certain situations that are explained in detail in the peer review report. When a firm receives a report with a peer review rating of *fail*, the peer reviewer has determined that the firm's system is not suitably designed or being complied with, and the reasons why are explained in detail in the report.

11. There are inherent limitations in the effectiveness of any system and, therefore, noncompliance with the system may occur and not be detected. A peer review is based on selective tests. It is directed at assessing whether the design of and compliance with the firm's system provides the firm with reasonable, not absolute, assurance of conforming to applicable professional standards. Consequently, it would not necessarily detect all weaknesses in the system or all instances of noncompliance with it. It does not provide assurance with respect to any individual engagement conducted by the firm or that none of the financial statements audited by the firm should be restated. Projection of any evaluation of a system to future periods is subject to the risk that the system may become inadequate because of changes in conditions or because the degree of compliance with the policies or procedures may deteriorate.

Engagement Reviews

12. An Engagement Review is a type of peer review that is a study and appraisal by an independent evaluator(s), known as a peer reviewer, of a sample of a CPA firm's actual accounting work, including accounting reports issued and documentation prepared by the CPA firm, as well as other procedures that the firm performed.

13. By definition, CPA firms undergoing Engagement Reviews do not perform audits or other similar engagements but do perform other accounting work including reviews and compilations, which are a lower level of service than audits. The peer reviewer's objective is to evaluate whether the CPA firm's reports are issued and procedures performed appropriately in accordance with applicable professional standards. Therefore, the objective of an Engagement Review is different from the objectives of a System Review, which is more system oriented and involves determining whether the system is designed in conformity with applicable professional standards and whether the firm is complying with its system appropriately.

14. Professional standards represent literature, issued by various organizations, that contain the framework and rules that a CPA firm is expected to follow when performing accounting work.

15. The reviewer looks at a sample of the CPA firm's work, individually called engagements. The scope of an Engagement Review only covers accounting engagements; it does not include tax or consulting services. An Engagement Review consists of reading the financial statements or information submitted by the reviewed firm and the accountant's report thereon, together with certain background

information and representations from the firm and, except for certain compilation engagements, the documentation required by applicable professional standards.

16. When the CPA firm receives a report with a peer review rating of *pass*, the peer reviewer has concluded that nothing came to his or her attention that the CPA firm's work was not performed and reported on in conformity with applicable professional standards in all material respects. A report with a peer review rating of *pass with deficiencies* is issued when the reviewer concludes that nothing came to his or her attention that the work was not performed and reported on in conformity with applicable professional standards in all material respects, except in certain situations that are explained in detail in the report. A report with a peer review rating of *fail* is issued when the reviewer concludes that as a result of the situations described in the report, the work was not performed or reported on in conformity with applicable professional standards in all material respects.

17. An Engagement Review does not provide the reviewer with a basis for expressing any assurance as to the firm's system of quality control for its accounting practice, and no opinion or any form of assurance is expressed on that system.

Quality Control Materials Reviews

18. An organization (hereinafter referred to as *provider*) may sell or otherwise distribute quality control materials (QCM or materials) that it has developed to CPA firms (hereinafter referred to as *user firms*). QCM may be all or part of a user firm's documentation of its system of quality control, and it may include manuals, guides, programs, checklists, practice aids (forms and questionnaires) and similar materials intended for use in conjunction with a user firm's accounting and auditing practice. User firms rely on QCM to assist them in performing and reporting in conformity with the professional standards covered by the materials (as described in the preceding paragraphs).

19. A QCM review is a study and appraisal by an independent evaluator (known as a QCM reviewer) of a provider's materials, as well as the provider's system of quality control to develop and maintain the materials (hereinafter referred to as *provider's system*). The QCM reviewer's objective is to determine whether the provider's system is designed and complied with and whether the materials produced by the provider are appropriate so that user firms can rely on the materials. The scope of a QCM review only covers materials related to accounting and auditing engagements under U.S. professional standards. The scope does not include SEC or PCAOB guidance, nor does it cover materials for tax or consulting services.

20. To plan a QCM review, a QCM reviewer obtains an understanding of (1) the provider's QCM, including the industries and professional standards that they cover, and (2) the design of the provider's system, including the provider's policies and procedures and how it ensures that they are being complied with. The QCM reviewer assesses the risk levels implicit within different aspects of the provider's system and materials. The QCM reviewer obtains this understanding through inquiry of provider personnel, review of documentation on the provider's system, and review of the materials.

21. Based on the planning procedures, the QCM reviewer looks at the provider's QCM, including the instructions, guidance, and methodology therein. The scope of a QCM review encompasses those materials which the provider elects to include in the QCM review report; QCM designed to aid user firms with tax or other non-attest services are outside of the scope of this type of review. The QCM reviewer will also look at the provider's system and will test elements including, but not limited to, requirements regarding the qualifications of authors and developers, procedures for ensuring that the QCM are current, procedures for reviewing the technical accuracy of the materials, and procedures for solicit-

ing feedback from users. The extent of a provider's policies and procedures and the manner in which they are implemented will depend upon a variety of factors, such as the size and organizational structure of the provider and the nature of the materials provided to users. Variance in individual performance and professional interpretation affects the degree of compliance with prescribed quality control policies and procedures. Therefore, adherence to all policies and procedures in every case may not be possible. The objectives of obtaining an understanding of the provider's system and the materials forms the basis for the QCM reviewer's conclusions in the QCM review report.

22. When a provider receives a QCM review report from an approved QCM reviewer with a review rating of *pass*, this means the provider's system is designed and being complied with and the materials produced by the provider are appropriate so that user firms can rely on the QCM to assist them in performing and reporting in conformity with the professional standards covered by the materials. If a provider receives a QCM review report with a review rating of *pass with deficiencies*, this means the provider's system is designed and being complied with and the materials produced by the provider are appropriate so that user firms can rely on the QCM to assist them in performing and reporting in conformity with the professional standards covered by the materials, except in certain situations that are explained in detail in the review report. When a provider receives a report with a review rating of *fail*, the QCM reviewer has determined that the provider's system is not suitably designed or being complied and the materials produced by the provider are not appropriate, and the reasons why are explained in detail in the report.

23. There are inherent limitations in the effectiveness of any system and, therefore, noncompliance with the system may occur and not be detected. A QCM review is based on the review of the provider's system and its materials. It is directed at assessing whether the provider's system is designed and complied with and whether the QCM produced by the provider are appropriate so that user firms have reasonable, not absolute, assurance that they can rely on the materials to assist them in performing and reporting in conformity with the professional standards covered by the materials. Consequently, a QCM review would not necessarily detect all weaknesses in the provider's system, all instances of noncompliance with it, or all aspects of the materials that should not be relied upon. Projection of any evaluation of a system or the materials to future periods is subject to the risk that the system or materials may become inadequate because of changes in conditions or because the degree of compliance with the policies or procedures may deteriorate.

## Appendix B

## Considerations and Illustrations of Firm Representations

**.208**

1. The team captain or review captain obtains written representations from management of the reviewed firm to describe matters significant to the peer review in order to assist in the planning and performance of and the reporting on the peer review. In connection with System and Engagement Reviews, specific representations should relate to the following matters, although the firm is not prohibited from making additional representations, and the firm may tailor the representation letter as it deems appropriate, as long as the minimum applicable representations are made to the team captain or review captain (see interpretations):

*a.* Situations or a summary of situations where management is aware that the firm or its personnel has not complied with the rules and regulations of state board(s) of accountancy or other regulatory bodies (including applicable firm and individual licensing requirements in each state in

which it practices for the year under review) and, if applicable, how the firm has or is addressing and rectifying situations of noncompliance (see interpretations).

*b.* Communications or summary 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 the three years preceding the firm's current peer review year-end and through the date of the exit conference. The information should be obtained in sufficient detail to consider its effect on the scope of the peer review (see interpretations). In addition, the reviewer may inquire if there are any other issues that may affect the firm's practice.

*c.* 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.

*d.* Completeness of the engagement listing provided to the reviewer, including, but not limited to, inclusion of all engagements performed, whether issued or not, under *Government Auditing Standards*, audits of employee benefit plans, audits performed under FDICIA, audits of carrying broker-dealers, examinations of service organizations Service Organizations Control (SOC) 1 and SOC 2 engagements, as applicable, and availability of the engagements with periods ending during the year under review, except financial forecasts or projections and agreed upon procedures. Financial forecasts or projections and agreed upon procedures with report dates during the year under review would be subject to selection.

*e.* Discussions of significant issues from reports or communications, or both (see interpretations), from other practice monitoring or external inspection programs, such as the PCAOB's (see interpretations), with the team captain.

*f.* Accepting responsibility for understanding, tailoring, and augmenting the quality control materials that the firm develops or adopts for use in its accounting and auditing practice.

*g.* Other representations obtained by the team captain or review captain will depend on the circumstances and nature of the peer review.

2. The written representations should be obtained for the entire firm and not for each individual engagement the firm performs. Firm management's refusal to furnish written representations to the team captain or review captain constitutes a failure to cooperate with the reviewer and thus the administering entity and with the AICPA Peer Review Board, and the firm would be subject to fair procedures that could result in the firm's enrollment in the program being terminated (see interpretations).

3. On System Reviews, the written representations should be addressed to the team captain. Because the team captain is concerned with events occurring during the peer review period and through the date of his or her peer review report that may require an adjustment to the report or other peer review documents, the representations should be dated the same date as the peer review report. The written representations should be signed by those members of management whom the team captain believes are responsible for and knowledgeable about, directly or through others in the firm, the matters covered in the representations, the firm, and its system of quality control. Such members of management normally include the managing partner and partner or manager in charge of the firm's system of quality control. If a representation made by management is contradicted by other information obtained, the team captain should

investigate the circumstances and consider the reliability of the representations made and any effect on the report.

4. On Engagement Reviews, the representations should be addressed to the review captain (for example, “To John Smith, CPA” or on committee-appointed review team reviews where appropriate, it may be addressed “To the Review Captain”) and dated the same date that the firm submits the list of engagements to the reviewer or the administering entity. The written representations should be signed by those members of management whom the reviewer or the administering entity believes are responsible for and knowledgeable about, directly or through others in the firm, the matters covered in the representations, the firm, and its system of quality control (even though an Engagement Review). Such members of management normally include the managing partner and partner or manager in charge of the firm’s system of quality control. If a representation made by management is contradicted by other information obtained, the reviewer should investigate the circumstances and consider the reliability of the representations made and any effect on the report.

**Illustration of a Representation Letter That has No Significant Matters to Report to the Team Captain or Review Captain**

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

October 31, 20XX

To the Team Captain or Review Captain

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

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

We have also provided a list of all engagements to the [team captain, review captain, or administering entity] with periods ending during the year under review whether issued or not. This list included, but was not limited to, all engagements performed under *Government Auditing Standards*, audits of employee benefit plans, audits performed under FDICIA, audits of carrying broker-dealers, and examinations of service organizations Service Organizations Control (SOC) 1 and SOC 2 engagements, as applicable. For financial forecasts or projections and agreed upon procedures, the list included those engagements with report dates during the year under review. We understand that failure to properly include these engagements on the list could be deemed as failure to cooperate. We also understand this may result in termination from the Peer Review Program and, if termination occurs, will result in referral of the matter to the AICPA Professional Ethics Division for investigation of a possible violation of the AICPA *Code of Professional Conduct.*

We have also provided the [team captain or review captain] with any other information requested, including communications by regulatory, monitoring, or enforcement bodies relating to allegations or investigations in the conduct of its accounting, audit, or attestation engagements 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. In addition, 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 which 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. We have also discussed the content of our PCAOB inspection report with the [team captain or review captain] (if applicable).

Sincerely,

[*Signature(s)* [fn 1] ]

**Illustration of a Representation Letter That Has Been Tailored to Report to the Team Captain a Matter of Noncompliance With a Regulatory Requirement**

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

October 31, 20XX

To the Team Captain or Review Captain

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

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

We have also provided a list of all engagements to the [team captain, review captain, or administering entity] with periods ending during the year under review whether issued or not. This list included, but was not limited to, all engagements performed under *Government Auditing Standards*, audits of employee benefit plans, audits performed under FDICIA, audits of carrying broker-dealers, and examinations of service organizations Service Organizations Control (SOC) 1 and SOC 2 engagements, as applicable. For financial forecasts or projections and agreed upon procedures, the list included those engagements

[fn 1] Members of management as noted in section 3 of appendix B, "Considerations and Illustrations of Firm Representations."

with report dates during the year under review. We understand that failure to properly include these engagements on the list could be deemed as failure to cooperate. We also understand this may result in termination from the Peer Review Program and, if termination occurs, will result in referral of the matter to the AICPA Professional Ethics Division for investigation of a possible violation of the AICPA *Code of Professional Conduct.*

We have also provided the [team captain] with any other information requested, including communications by regulatory, monitoring, or enforcement bodies relating to allegations or investigations in the conduct of its accounting, audit, or attestation engagements 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. In addition, there are no known restrictions or limitations on the firm's or its personnel's ability to practice public accounting within three years preceding the current peer review year-end.

We understand the intended uses and limitations of the quality control materials we have developed or adopted. We have tailored and augmented the materials as appropriate such that the quality control materials encompass guidance which 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. We have also discussed the content of our Public Company Accounting Oversight Board inspection report with the team captain (if applicable).

Sincerely,

[*Signature(s)* [fn 2] ]

## Appendix C

## Illustration of a Report With a Peer Review Rating of *Pass* in a System Review

**.209**

[*Firm letterhead for a firm-on-firm review; team captain's firm letterhead for an association formed review team*.]

**System Review Report**

October 31, 20XX

To the Partners of [*or other appropriate terminology*] XYZ & Co. and the Peer Review Committee of the [*insert the name of the applicable administering entity*] [fn 1]

---

[fn 2] Members of management as noted in section 3 of appendix B, "Considerations and Illustrations of Firm Representations."

[fn 1] The report of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: To the Partners of [or appropriate terminology] XYZ & Co. and the National Peer Review Committee.

We [fn 2] have reviewed the system of quality control for the accounting and auditing practice of XYZ & Co. (the firm) [fn 3] 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. As a part of our peer review, we considered reviews by regulatory entities, if applicable, in determining the nature and extent of our procedures. 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. 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. The nature, objectives, scope, limitations of, and the procedures performed in a System Review are described in the standards at www.aicpa.org/prsummary.

As required by the standards, engagements selected for review included (engagements performed under *Government Auditing Standards*; audits of employee benefit plans, audits performed under FDICIA, audits of carrying broker-dealers, and examinations of service organizations [Service Organizations Control (SOC) 1 and SOC 2 engagements].) [fn 4]

In our opinion, the system of quality control for the accounting and auditing practice of XYZ & Co. [fn 5] 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*.

Smith, Jones and Associates

[*Name of team captain's firm*]

---

[fn 2] The report should use the plural *we*, *us*, and *our* even if the review team consists of only one person. The singular *I*, *me*, and *my* are appropriate only if the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

[fn 3] The report of a firm who is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

[fn 4] If the firm performs audits of employee benefit plans, engagements performed under *Government Auditing Standards*, audits of depository institutions with total assets of $500 million or greater at the beginning of its fiscal year, audits of carrying broker-dealers, examinations of service organizations (Service Organization Control [SOC] 1 and SOC 2), or other engagements required to be selected by the board in interpretations, the engagement type(s) selected for review should be identified in the report using this paragraph, tailored as applicable. For SOC engagements, the paragraph should be tailored to reflect the type(s) selected for review. If the firm does not perform such engagements, this paragraph is not applicable and not included in the report.

[fn 5] The report of a firm who is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

# Appendix D

## Illustration of a Report With a Peer Review Rating of *Pass (With a Scope Limitation)* in a System Review

**.210**

### Limitation on Scope of Review

A report with a scope limitation should be issued when the scope of the review is limited by conditions (including those discussed in the standards*)* that preclude the application of one or more peer review procedure(s) considered necessary in the circumstances and the review team cannot accomplish the objectives of those procedures through alternate procedures. For example, a review team may be able to apply appropriate alternate procedures if one or more engagements have been excluded from the scope of the review. Ordinarily, however, the team would be unable to apply alternate procedures if the firm's only engagement in an industry that must be selected is unavailable for review and there isn't an earlier issued engagement that may be able to replace it, or when a significant portion of the firm's accounting and auditing practice during the year reviewed had been divested before the review began (see interpretation). A scope limitation may be included in a report with a peer review rating of *pass, pass with deficiency(ies)* or *fail*. In this example, the scope limitation was included in a report with a peer review rating of *pass*.

[*Firm letterhead for a firm-on-firm review; team captain's firm letterhead for an association formed review team*.]

**System Review Report**

October 31, 20XX

To the Partners of [*or other appropriate terminology*] XYZ & Co. and the Peer Review Committee of the [*insert the name of the applicable administering entity*] [fn 1]

We [fn 2] have reviewed the system of quality control for the accounting and auditing practice of XYZ & Co. (the firm) [fn 3] in effect for the year ended June 30, 20XX. Our peer review was conducted in accord-

---

[fn 1] The report of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: To the Partners of [or appropriate terminology] XYZ & Co. and the National Peer Review Committee.

[fn 2] The report should use the plural *we*, *us*, and *our* even if the review team consists of only one person. The singular *I*, *me*, and *my* are appropriate only if the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

[fn 3] The report of a firm who is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

ance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. As a part of our peer review, we considered reviews by regulatory entities, if applicable, in determining the nature and extent of our procedures. 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. 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. The nature, objectives, scope, limitations of, and the procedures performed in a System Review are described in the standards at www.aicpa.org/prsummary.

As required by the standards, engagements selected for review included (engagements performed under *Government Auditing Standards*; audits of employee benefit plans, audits performed under FDICIA, audits of carrying broker-dealers, and examinations of service organizations [Service Organizations Control (SOC) 1 and SOC 2 engagements]). [fn 4]

In performing our review, the firm notified us that we would be unable to review the engagements performed by one of its former partners who left the firm during the peer review year. Accordingly, we were unable to include in our engagement selection any of the divested engagements. That partner's responsibility was concentrated in the construction industry. The engagements excluded from our engagement selection process included audit engagements and comprised approximately 15 percent of the firm's audit and accounting practice during the peer review year.

In our opinion, except for any deficiencies or significant deficiencies that might have come to our attention had we been able to review divested engagements, as previously described, the system of quality control for the accounting and auditing practice of XYZ & Co. [fn 5] 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 (with a scope limitation).*

Smith, Jones and Associates

[*Name of team captain's firm*]

## Appendix E

---

[fn 4] If the firm performs audits of employee benefit plans, engagements performed under *Government Auditing Standards*, audits of depository institutions with total assets of $500 million or greater at the beginning of its fiscal year, audits of carrying broker-dealers, examinations of service organizations (Service Organization Control [SOC] 1 and SOC 2) or other engagements required to be selected by the board in interpretations, the engagement type(s) selected for review should be identified in the report using this paragraph, tailored as applicable. For SOC engagements, the paragraph should be tailored to reflect the type(s) selected for review. If the firm does not perform such engagements, this paragraph is not applicable and not included in the report.

[fn 5] The report of a firm who is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

## Illustration of a Report With a Peer Review Rating of *Pass With Deficiencies* in a System Review

**.211**

The deficiencies and related recommendations provided are examples provided for illustrative purposes only. Any one or more of the deficiencies, based on the relative importance of the deficiency to the system of quality control as a whole, could result in a report with a peer review rating of *pass with deficiencies* or *fail*.

[*Firm letterhead for a firm-on-firm review; team captain's firm letterhead for an association formed review team.*]

**System Review Report**

August 31, 20XX

To the Partners of [*or other appropriate terminology*] XYZ & Co. and the Peer Review Committee of the [*insert the name of the applicable administering entity*] [fn 1]

We [fn 2] have reviewed the system of quality control for the accounting and auditing practice of XYZ & Co. (the firm) [fn 3] 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. As a part of our peer review, we considered reviews by regulatory entities, if applicable, in determining the nature and extent of our procedures. 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. 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. The nature, objectives, scope, limitations of, and the procedures performed in a System Review are described in the standards at www.aicpa.org/prsummary.

As required by the standards, engagements selected for review included (engagements performed under *Government Auditing Standards*; audits of employee benefit plans, audits performed under FDICIA, au-

---

[fn 1] The report of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: To the Partners of [or appropriate terminology] XYZ & Co. and the National Peer Review Committee.

[fn 2] The report should use the plural *we*, *us*, and *our* even if the review team consists of only one person. The singular *I*, *me*, and *my* are appropriate only if the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

[fn 3] The report of a firm who is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

dits of carrying broker-dealers, and examinations of service organizations [Service Organizations Control (SOC) 1 and SOC 2 engagements]). [fn 4]

We noted the following deficiencies during our review:

1. Deficiency—The firm's quality control policies and procedures do not provide its staff with a means of ensuring that all necessary procedures are performed on review and compilation engagements. As a result, the firm's review and compilation working papers did not include documentation of all procedures required by professional standards, in particular relating to accounts and notes payable. We were able to satisfy ourselves that, in each case, sufficient procedures had been performed, and the firm subsequently prepared the appropriate documentation.

   Recommendation—The firm's quality control policies and procedures should be revised to ensure documentation of all procedures performed as required by professional standards. Although not required by professional standards, the firm should consider using the practice aids in the reference manuals available in the firm's library in order to accomplish this step.

2. Deficiency—The firm's quality control policies and procedures do not require partner involvement in the planning stage of audit engagements. Generally accepted auditing standards permit the auditor with final responsibility for the engagement to delegate some of this work to assistants, but the standards emphasize the importance of proper planning to the conduct of the engagement. We found several audits performed in which, as a result of a lack of involvement including timely supervision by the engagement partner in planning the audit, the work performed on contracts, contract provisions, and related receivables did not support the firm's opinion on the financial statements. The firm has subsequently performed the necessary additional procedures to provide a satisfactory basis for its opinion.

   Recommendation—The firm's quality control policies and procedures should be revised to provide, at a minimum, for timely audit partner review of the preliminary audit plan and the audit program. The firm should ensure that this is addressed as part of its ongoing monitoring procedures.

3. Deficiency—The firm's quality control policies and procedures require that financial statement reporting and disclosure checklists appropriate to the industry of the engagement being performed be completed. Our review noted that these checklists were not being used on all audit engagements. As a result, on certain audit engagements in the construction industry, the financial statements were missing several significant disclosures specific to the industry as required by generally accepted accounting principles. The subject reports have been recalled, and the financial statements are being revised.

---

[fn 4] If the firm performs audits of employee benefit plans, engagements performed under *Government Auditing Standards*, audits of depository institutions with total assets of $500 million or greater at the beginning of its fiscal year, audits of carrying broker-dealers, examinations of service organizations (Service Organization Control [SOC] 1 and SOC 2) or other engagements required to be selected by the board in interpretations, the engagement type(s) selected for review should be identified in the report using this paragraph, tailored as applicable. For SOC engagements, the paragraph should be tailored to reflect the type(s) selected for review. If the firm does not perform such engagements, this paragraph is not applicable and not included in the report.

Recommendation—The firm should conduct a training session for all personnel to review the firm's policies and procedures for utilizing financial statement reporting and disclosure checklists that are appropriate to the industry of an engagement. The engagement partner should carefully review these checklists at the completion of an engagement to ensure that the appropriate checklists are utilized and to ensure their proper completion as required by firm policy. This can be accomplished by adding a procedure to the firm's engagement review checklist requiring the engagement partner to document his or her review of these checklists.

In our opinion, except for the deficiencies previously described, the system of quality control for the accounting and auditing practice of XYZ & Co.[fn 5] 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 with deficiencies*.

Smith, Jones and Associates

[*Name of team captain's firm*]

## Appendix F

## Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Pass With Deficiencies* in a System Review

**.212**

The purpose of a letter of response is to describe the actions the firm has taken or will take, including the timing of the planned actions, to prevent a recurrence of each deficiency discussed in the report. If the reviewed firm disagrees with one or more of the deficiencies or recommendations in the report, the reviewed firm should contact the administering entity for assistance. If the firm still disagrees after contacting the administering entity, the firm's response should describe the reasons for such disagreement. For more information related to disagreements, see paragraph .93 of the standards. The letter of response should be carefully prepared because of the important bearing it may have on the decisions reached in connection with acceptance of the report on the review (see paragraphs .136–.140, "Accepting System and Engagement Reviews"). The letter of response should be submitted to the team captain for review and comment prior to the firm submitting the response to the administering entity.

[*Reviewed firm's letterhead*]

September 21, 20XX

---

[fn 5] The report of a firm who is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

[*Addressed to the peer review committee of the administering entity*] [fn 1]

Ladies and Gentlemen:

This letter represents our [fn 2] response to the report issued in connection with the peer review of the firm's system of quality control for the accounting and auditing practice in effect for the year ended June 30, 20XX. The corrective actions discussed in this letter will be monitored to ensure that they are effectively implemented as part of our system of quality control.

1. [fn 3] The firm modified its quality control policies and procedures to require the use of practice aids to document procedures performed on review and compilation engagements, especially for accounts and notes payable. Partners were instructed to ensure that these aids were being utilized appropriately when reviewing engagements. This policy was discussed in a recent training session held in connection with a recent firm-wide staff meeting.

2. The firm also modified its quality control policies and procedures to place a greater emphasis on partner involvement in the planning stage of all audit engagements. The revised policies and procedures require the engagement owner to document his or her timely involvement in the planning process in the planning section of the written work program. The importance of proper planning, including timely partner involvement, to quality work was emphasized in the training session previously referred.

3. In addition, at that training session, the importance of proper use of the firm's reporting and disclosure checklists appropriate to the industry of the engagement being performed was discussed. We discussed the proper resolution of points or topics unfamiliar to the individual completing the checklist or those reviewing its completion. The firm's CPE plan for partners and managers now includes annual updates on industry specific disclosure issues.

As previously mentioned, these corrective actions will also be emphasized in our monitoring procedures and internal inspection.

We believe these actions are responsive to the findings of the review.

Sincerely,

---

[fn 1] The response of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: To the National Peer Review Committee.

[fn 2] The response should use the singular *I, me,* and *my* only when the reviewed firm is a sole practitioner.

[fn 3] The numbering of responses, to coincide with the numbered comments in the report, is optional.

[*Name of Firm*] [fn 4]

# Appendix G

## Illustration of a Report With a Peer Review Rating of *Pass With Deficiencies* (*With a Scope Limitation*) in a System Review

**.213**

The deficiencies and related recommendations provided are examples provided for illustrative purposes only. Any one or more of the deficiencies, based on the relative importance of the deficiency to the system of quality control as a whole, could result in a report with a peer review rating of *pass with deficiencies* or *fail*.

**Limitation on Scope of Review**

A report with a scope limitation should be issued when the scope of the review is limited by conditions (including those discussed in the standards*)* that preclude the application of one or more peer review procedure(s) considered necessary in the circumstances and the review team cannot accomplish the objectives of those procedures through alternate procedures. For example, a review team may be able to apply appropriate alternate procedures if one or more engagements have been excluded from the scope of the review. Ordinarily, however, the team would be unable to apply alternate procedures if the firm's only engagement in an industry that must be selected is unavailable for review and there isn't an earlier issued engagement that may be able to replace it, or when a significant portion of the firm's accounting and auditing practice during the year reviewed had been divested before the review began (see interpretation). A scope limitation may be included in a report with a peer review rating of *pass*, *pass with deficiency(ies*), or *fail*. In this example, the scope limitation was included in a report with a peer review rating of *pass with deficiencies*, where one of the deficiencies related to the circumstances of the scope limitation.

[*Firm letterhead for a firm-on-firm review; team captain's firm letterhead for an association formed review team.*]

**System Review Report**

October 31, 20XX

To the Partners of [*or other appropriate terminology*] XYZ & Co. and the Peer Review Committee of the [*insert the name of the applicable administering entity*] [fn 1]

---

[fn 4] Signed by an authorized partner of the firm.

[fn 1] The report of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: To the Partners of [or appropriate terminology] XYZ & Co. and the National Peer Review Committee.

We [fn 2] have reviewed the system of quality control for the accounting and auditing practice of XYZ & Co. (the firm) [fn 3] in effect for the year ended June 30, 20XX. Except as subsequently described, 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. As a part of our peer review, we considered reviews by regulatory entities, if applicable, in determining the nature and extent of our procedures. 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. 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. The nature, objectives, scope, limitations of, and the procedures performed in a System Review are described in the standards at www.aicpa.org/prsummary.

As required by the standards, engagements selected for review included (audits of employee benefit plans, audits performed under FDICIA, audits of carrying broker-dealers, and examinations of service organizations [Service Organizations Control (SOC) 1 and SOC 2 engagements]). [fn 4]

In performing our review, the firm notified us that we would be unable to select its only audit subject to *Government Auditing Standards* (Yellow Book). As a result, we were unable to review all of the types of engagements required to be selected by the standards established by the Peer Review Board of the AICPA.

We noted the following deficiencies during our review:

1. Deficiency—The firm's quality control policies and procedures do not require partner involvement in the planning stage of audit engagements. Generally accepted auditing standards permit the auditor with final responsibility for the engagement to delegate some of this work to assistants, but the standards emphasize the importance of proper planning to the conduct of the engagement. We found several audits performed in which, as a result of a lack of involvement, including timely supervision by the engagement partner in planning the audit, the work performed on contracts, contract provisions, and related receivables did not support the firm's opinion on

---

[fn 2] The report should use the plural *we, us,* and *our* even if the review team consists of only one person. The singular *I, me*, and *my* are appropriate only if the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

[fn 3] The report of a firm who is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

[fn 4] If the firm performs audits of employee benefit plans, engagements performed under *Government Auditing Standards*, audits of depository institutions with total assets of $500 million or greater at the beginning of its fiscal year, audits of carrying broker-dealers, examinations of service organizations (Service Organization Control [SOC] 1 and SOC 2) or other engagements required to be selected by the board in interpretations, the engagement type(s) selected for review should be identified in the report using this paragraph, tailored as applicable. For SOC engagements, the paragraph should be tailored to reflect the type(s) selected for review. If the firm does not perform such engagements, this paragraph is not applicable and not included in the report.

the financial statements. The firm has subsequently performed the necessary additional procedures to provide a satisfactory basis for its opinion.

Recommendation—The firm's quality control policies and procedures should be revised to provide, at a minimum, for timely audit partner review of the preliminary audit plan and the audit program. The firm should ensure that this is addressed as part of its ongoing monitoring procedures.

2. Deficiency—As previously noted, in performing our review, the firm notified us that we would be unable to select its only audit subject to *Government Auditing Standards* (Yellow Book). As a result, the firm was not in compliance with the Yellow Book peer review engagement selection requirements.

   Recommendation—We recommend that the firm consider the importance of adhering to the Yellow Book requirements and the possible consequences of noncompliance.

In our opinion, except for the effects of the deficiency previously described and any additional deficiencies or significant deficiencies that might have come to our attention had we been able to review the engagement as previously described, the system of quality control for the accounting and auditing practice of XYZ & Co.[fn 5] 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 with deficiencies (with a scope limitation).*

Smith, Jones and Associates

[*Name of team captain's firm*]

## Appendix H

## Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Pass With Deficiencies (With a Scope Limitation)* in a System Review

**.214**

The purpose of a letter of response is to describe the actions the firm has taken or will take, including the timing of the planned actions, to prevent a recurrence of each deficiency discussed in the report. If the reviewed firm disagrees with one or more of the deficiencies or recommendations in the report, the reviewed firm should contact the administering entity for assistance. If the firm still disagrees after contacting the administering entity, the firm's response should describe the reasons for such disagreement. For more information related to disagreements, see paragraph .93 of the standards. The letter of response should be carefully prepared because of the important bearing it may have on the decisions reached in

[fn 5] The report of a firm who is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

connection with acceptance of the report on the review (see paragraphs .136–.140, "Accepting System and Engagement Reviews"). The letter of response should be submitted to the team captain for review and comment prior to the firm submitting the response to the administering entity.

[*Reviewed firm's letterhead*]

November 30, 20XX

[*Addressed to the peer review committee of the administering entity*] [fn 1]

Ladies and Gentlemen:

This letter represents our [fn 2] response to the report issued in connection with the peer review of the firm's system of quality control for the accounting and auditing practice in effect for the year ended June 30, 20XX.

1. [fn 3] The firm also modified its quality control policies and procedures to place a greater emphasis on partner involvement in the planning stage of all audit engagements. The revised policies and procedures require the engagement owner to document his or her timely involvement in the planning process in the planning section of the written work program. The importance of proper planning, including timely partner involvement, to quality work was emphasized in a recent training session held in conjunction with a recent firm-wide staff meeting.

2. Due to circumstances that we deemed appropriate, we notified the peer reviewer that he would be unable to select our only audit subject to *Government Auditing Standards* in the peer review. This is the only governmental audit the firm has performed, so there were no previous audits for the reviewer to select. We suggested selecting an audit engagement in a different industry. We have considered the consequences of noncompliance related to this matter.

Sincerely,

[*Name of Firm*] [fn 4]

---

[fn 1] The response of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: To the National Peer Review Committee.

[fn 2] The response should use the singular *I, me,* and *my* only when the reviewed firm is a sole practitioner.

[fn 3] The numbering of responses, to coincide with the numbered comments in the report, is optional.

[fn 4] Signed by an authorized partner of the firm.

# Appendix I

## Illustration of a Report With a Peer Review Rating of *Fail* in a System Review

**.215**

The deficiencies and related recommendations provided are examples provided for illustrative purposes only. Any one or more of the deficiencies, based on the relative importance of the deficiency to the system of quality control as a whole, could result in a report with a peer review rating of *pass with deficiencies* or *fail*.

[*Firm letterhead for a firm-on-firm review; team captain's firm letterhead for an association formed review team.*]

**System Review Report**

October 31, 20XX

To the Partners of [*or other appropriate terminology*] XYZ & Co. and the Peer Review Committee of the [*insert the name of the applicable administering entity*] [fn 1]

We [fn 2] have reviewed the system of quality control for the accounting and auditing practice of XYZ & Co. (the firm) [fn 3] 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. As a part of our peer review, we considered reviews by regulatory entities, if applicable, in determining the nature and extent of our procedures. 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. 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. The nature, objectives, scope, limitations of, and the procedures performed in a System Review are described in the standards at www.aicpa.org/prsummary.

---

[fn 1] The report of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: To the Partners of [or appropriate terminology] XYZ & Co. and the National Peer Review Committee.

[fn 2] The report should use the plural *we*, *us*, and *our* even if the review team consists of only one person. The singular *I*, *me*, and *my* are appropriate only if the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

[fn 3] The report of a firm who is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

As required by the standards, engagements selected for review included (engagements performed under *Government Auditing Standards*; audits of employee benefit plans, audits performed under FDICIA, audits of carrying broker-dealers, and examinations of service organizations [Service Organizations Control (SOC) 1 and SOC 2 engagements]). [fn 4]

We noted the following significant deficiencies [fn 5] during our review:

1. Deficiency—The firm's quality control policies and procedures do not require written audit programs as required by professional standards. As a result, we noted several instances in which audit procedures were not adequately performed and documented in the areas of investments and expenses. As a result, the audit work performed for several audits did not support the opinion issued and was not performed in conformity with applicable professional standards. The firm has subsequently performed the omitted procedures to support the audit opinions.

   Recommendation—The firm's quality control policies and procedures should require the use of audit programs on all audits. All audit programs should be retained with the engagement working papers.

2. Deficiency—The firm's quality control policies and procedures require consultation based upon the following factors: materiality, experience in a particular industry or functional area, and familiarity with the accounting principles or auditing requirements in a specialized area. We noted instances in which the firm did not consult during the year, either by use of the firm's technical reference material or by requesting assistance from outside the firm. As a result, financial statements on audits for common interest realty associations did not conform with applicable professional standards. The firm was not aware of the unique disclosure and statement presentations required until it was brought to its attention during the peer review. The firm intends to recall and reissue the financial statements and reports.

   Recommendation—The firm should emphasize its consultation policies and procedures on those engagements that are new to the experience level of the firm's accounting and auditing personnel.

3. Deficiency—The firm's quality control policies and procedures do not provide its personnel with a means of ensuring that all necessary procedures are performed on Employee Retirement Income Security Act (ERISA) engagements. During our review, we noted that the firm failed to adequately perform, including appropriately documenting, procedures related to benefit pay-

---

[fn 4] If the firm performs audits of employee benefit plans, engagements performed under *Government Auditing Standards*, audits of depository institutions with total assets of $500 million or greater at the beginning of its fiscal year, audits of carrying broker-dealers, examinations or service organizations (Service Organization Control [SOC] 1 and SOC 2) or other engagements required to be selected by the board in interpretations, the engagement type(s) selected for review should be identified in the report using this paragraph, tailored as applicable. For SOC engagements, the paragraph should be tailored to reflect the type(s) selected for review. If the firm does not perform such engagements, this paragraph is not applicable and not included in the report.

[fn 5] When considered together, the deficiencies rise to the level of significant deficiencies.

ments on ERISA engagements. The firm has subsequently performed the testing and documented its procedures.

Recommendation—The firm should review and implement the requirements of specialized industries. This can be accomplished by the purchase and use of practice aids tailored to the industry.

4. Deficiency—The firm's quality control policies and procedures require that financial statement reporting and disclosure checklists be completed for all engagements. Our review noted that these checklists were not being used on all engagements. As a result, the reviewed financial statements in the construction industry were missing several significant disclosures as required by generally accepted accounting principles. The subject reports have been recalled, and the financial statements are being revised.

   Recommendation—The firm should conduct a training session for all personnel to review the firm's policies and procedures for utilizing financial statement reporting and disclosure checklists specific to the industry of the engagement, when available. The engagement partner should carefully review these checklists at the completion of an engagement to ensure their proper completion as required by firm policy. This can be accomplished by adding a procedure to the firm's engagement review checklist requiring the engagement partner to document his or her review of these checklists.

In our opinion, as a result of the significant deficiencies previously described, the system of quality control for the accounting and auditing practice of XYZ & Co.[fn 6] in effect for the year ended June 30, 20XX, was not suitably designed or complied with to provide the firm with reasonable assurance of performing or 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 *fail*.

Smith, Jones and Associates

[*Name of team captain's firm*]

## Appendix J

## Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Fail* in a System Review

**.216**

The purpose of a letter of response is to describe the actions the firm has taken or will take, including the timing of the planned actions, to prevent a recurrence of each of the significant deficiencies discussed in the report. If the reviewed firm disagrees with one or more of the significant deficiencies or recommen-

---

[fn 6] The report of a firm who is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

dations in the report, the reviewed firm should contact the administering entity for assistance. If the firm still disagrees after contacting the administering entity, the firm's response should describe the reasons for such disagreement. For more information related to disagreements, see paragraph .93 of the standards. The letter of response should be carefully prepared because of the important bearing it may have on the decisions reached in connection with acceptance of the report on the review (see paragraphs .136–.140, "Accepting System and Engagement Reviews"). The letter of response should be submitted to the team captain for review and comment prior to the firm submitting the response to the administering entity.

November 30, 20XX

[*Addressed to the peer review committee of the administering entity*] [fn 1]

Ladies and Gentlemen:

This letter represents our [fn 2] response to the report issued in connection with the peer review of the firm's system of quality control for the accounting and auditing practice in effect for the year ended June 30, 20XX. All issues have been brought to the attention of personnel at a meeting held on November 22, 20XX. In addition, steps have been added to our monitoring procedures to review the deficiencies noted in the report so that they will not happen again.

1. [fn 3] Several of the deficiencies noted by the review team included missing or incomplete audit and review documentation. All individuals with responsibility for managing audit and accounting engagements have been reminded of their responsibility to ensure the applicable professional standards for performing and documenting engagements are followed. In addition, we have implemented a concurring partner review on all audit and review engagements, and the quality of audit documentation will be a focus of the concurring partner's review.

2. The firm has contacted two other accounting firms with expertise in Employee Retirement Income Security Act (ERISA) audits, common interest realty associations, and other industries that are similar to ours. We have implemented a plan for consultation with these firms for guidance in situations with which we are unfamiliar.

3. We have purchased practice aids that are specific to the industries of our clients and have instructed staff and partners on their use.

---

[fn 1] The response of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: To the National Peer Review Committee.

[fn 2] The response should use the singular *I, me,* and *my* only when the reviewed firm is a sole practitioner.

[fn 3] The numbering of responses, to coincide with the numbered comments in the report, is optional.

4. At the staff meeting previously mentioned, the importance of proper use of the firm's reporting and disclosure checklist was discussed, including the use of checklists for specialized industries. We discussed the proper resolution of points or topics unfamiliar to the individual completing the checklist or those reviewing its completion. The firm's CPE plan for partners and managers now includes annual updates on disclosure issues.

The firm is committed to strengthening its monitoring policies and procedures, especially as they relate to a timely post-issuance review of engagements. We have acquired quality control materials to guide the firm, and supervision of the monitoring process has been assigned to a partner. Additionally, outside assistance (as previously mentioned) has been sought, and this individual will be available for consultation and guidance.

Sincerely,

[*Name of Firm*] [fn 4]

# Appendix K

## Illustration of a Report With a Peer Review Rating of *Fail (With a Scope Limitation)* in a System Review

**.217**

The deficiencies and related recommendations provided are examples provided for illustrative purposes only. Any one or more of the deficiencies, based on the relative importance of the deficiency to the system of quality control as a whole, could result in a report with a peer review rating of *pass with deficiencies* or *fail*.

### Limitation on Scope of Review

A report with a scope limitation should be issued when the scope of the review is limited by conditions (including those discussed in the standards) that preclude the application of one or more peer review procedure(s) considered necessary in the circumstances and the review team cannot accomplish the objectives of those procedures through alternate procedures. For example, a review team may be able to apply appropriate alternate procedures if one or more engagements have been excluded from the scope of the review. Ordinarily, however, the team would be unable to apply alternate procedures if the firm's only engagement in an industry that must be selected is unavailable for review and there is not an earlier issued engagement that may be able to replace it, or when a significant portion of the firm's accounting and auditing practice during the year reviewed had been divested before the review began (see interpretation). A scope limitation may be included in a report with a peer review rating of *pass*, *pass with deficiency(ies)*, or *fail*. In this example, the scope limitation was included in a report with a peer review rating of *fail*.

[fn 4] Signed by an authorized partner of the firm.

[*Firm letterhead for a firm-on-firm review; team captain's firm letterhead for an association formed review team.*]

**System Review Report**

October 31, 20XX

To the Partners of [*or other appropriate terminology*] XYZ & Co. and the Peer Review Committee of the [*insert the name of the applicable administering entity*] [fn 1]

We [fn 2] have reviewed the system of quality control for the accounting and auditing practice of XYZ & Co. (the firm) [fn 3] 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. As a part of our peer review, we considered reviews by regulatory entities, if applicable, in determining the nature and extent of our procedures. 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. 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. The nature, objectives, scope, limitations of, and the procedures performed in a System Review are described in the standards at www.aicpa.org/prsummary.

As required by the standards, engagements selected for review included (engagements performed under *Government Auditing Standards*; audits of employee benefit plans, audits performed under FDICIA, audits of carrying broker-dealers, and examinations of service organizations [Service Organizations Control (SOC) 1 and SOC 2 engagements]). [fn 4]

---

[fn 1] The report of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: To the Partners of [or appropriate terminology] XYZ & Co. and the National Peer Review Committee.

[fn 2] The report should use the plural *we*, *us*, and *our* even if the review team consists of only one person. The singular *I*, *me*, and *my* are appropriate only if the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

[fn 3] The report of a firm who is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

[fn 4] If the firm performs audits of employee benefit plans, engagements performed under *Government Auditing Standards*, audits of depository institutions with total assets of $500 million or greater at the beginning of its fiscal year, audits of carrying broker-dealers, examinations of service organizations (Service Organization Control [SOC] 1 and SOC 2) or other engagements required to be selected by the board in interpretations, the engagement type(s) selected for review should be identified in the report using this paragraph, tailored as applicable. For SOC engagements, the paragraph should be tailored to reflect the type(s) selected for review. If the firm does not perform such engagements, this paragraph is not applicable and not included in the report.

In performing our review, the firm notified us that we would be unable to review the engagements performed by one of the firm's four offices that divested from the firm during the peer review year. As a result, we were unable to include within our engagement selection any engagements issued by that office. The engagements excluded from our engagement selection process included audit engagements and composed approximately 20 percent of the firm's audit and accounting hours during the peer review year.

In addition, we noted the following significant deficiencies [fn 5] during our review:

1. Deficiency—The firm's quality control policies and procedures do not require written audit programs as required by professional standards. As a result, we noted several instances in which audit procedures were not adequately performed and documented in the areas of investments and expenses. As a result, the audit work performed for several audits did not support the opinion issued and was not performed in conformity with applicable professional standards. The firm has subsequently performed the omitted procedures to support the audit opinions.

   Recommendation—The firm's quality control policies and procedures should require the use of audit programs on all audits. All audit programs should be retained with the engagement working papers.

2. Deficiency—The firm's quality control policies and procedures require consultation based upon the following factors: materiality, experience in a particular industry or functional area, and familiarity with the accounting principles or auditing requirements in a specialized area. We noted instances in which the firm did not consult during the year, either by use of the firm's technical reference material or by requesting assistance from outside the firm. As a result, financial statements on audits for common interest realty associations did not conform with applicable professional standards. The firm was not aware of the unique disclosure and statement presentations required until it was brought to its attention during the peer review. The firm intends to recall and reissue the financial statements and reports.

   Recommendation—The firm should emphasize its consultation policies and procedures on those engagements that are new to the experience level of the firm's accounting and auditing personnel.

3. Deficiency—The firm's quality control policies and procedures do not provide its personnel with a means of ensuring that all necessary procedures are performed on Employee Retirement Income Security Act (ERISA) engagements. During our review, we noted that the firm failed to adequately perform, including appropriately documenting, procedures related to benefit payments on ERISA engagements. The firm has subsequently performed the testing and documented its procedures.

   Recommendation—The firm should review and implement the requirements of specialized industries. This can be accomplished by the purchase and use of practice aids tailored to the industry.

---

[fn 5] When considered together, the deficiencies rise to the level of significant deficiencies.

4. Deficiency—The firm's quality control policies and procedures require that financial statement reporting and disclosure checklists be completed for all engagements. Our review noted that these checklists were not being used on all engagements. As a result, the reviewed financial statements in the construction industry were missing several significant disclosures as required by generally accepted accounting principles. The subject reports have been recalled and the financial statements are being revised.

   Recommendation—The firm should conduct a training session for all personnel to review the firm's policies and procedures for utilizing financial statement reporting and disclosure checklists specific to the industry of the engagement, when available. The engagement partner should carefully review these checklists at the completion of an engagement to ensure their proper completion as required by firm policy. This can be accomplished by adding a procedure to the firm's engagement review checklist requiring the engagement partner to document his or her review of these checklists.

In our opinion, as a result of the significant deficiencies previously described, and any additional significant deficiencies that might have come to our attention had we been able to review engagements from the divested office as previously described, the system of quality control for the accounting and auditing practice of XYZ & Co. [fn 6] in effect for the year ended June 30, 20XX was not suitably designed or complied with to provide the firm with reasonable assurance of performing or 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 *fail (with a scope limitation).*

Smith, Jones and Associates

[*Name of team captain's firm*]

## Appendix L

## Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Fail (With a Scope Limitation)* in a System Review

**.218**

The purpose of a letter of response is to describe the actions the firm has taken or will take including the timing of the planned actions, to prevent a recurrence of each of the significant deficiencies discussed in the report. If the reviewed firm disagrees with one or more of the significant deficiencies, or recommendations in the report, the reviewed firm should contact the administering entity for assistance. If the firm still disagrees after contacting the administering entity, the firm's response should describe the reasons for such disagreement. For more information related to disagreements, see paragraph .93 of the standards. The letter of response should be carefully prepared because of the important bearing it may have on the decisions reached in connection with acceptance of the report on the review (see paragraphs

---

[fn 6] The report of a firm who is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

.136–.140, "Accepting System and Engagement Reviews"). The letter of response should be submitted to the team captain for review and comment prior to the firm submitting the response to the administering entity.

November 30, 20XX

[*Addressed to the peer review committee of the administering entity*] [fn 1]

Ladies and Gentlemen:

This letter represents our [fn 2] response to the report issued in connection with the peer review of the firm's system of quality control for the accounting and auditing practice in effect for the year ended June 30, 20XX. All issues have been brought to the attention of the personnel at a meeting held on November 22, 20XX. In addition, steps have been added to our monitoring procedures to review the deficiencies noted in the report so that they will not happen again.

We notified our peer reviewer that he would be unable to review the engagements performed by one of our firm's four offices that divested from our firm during the peer review year. We have considered the consequences of this scope limitation on the results of our peer review.

1. [fn 3] Several of the deficiencies noted by the review team included missing or incomplete audit and review documentation. All individuals with responsibility for managing audit and accounting engagements have been reminded of their responsibility to ensure the applicable professional standards for performing and documenting engagements are followed. In addition, we have implemented a concurring partner review on all audit and review engagements, and the quality of audit documentation will be a focus of the concurring partner's review.

2. The firm has contacted two other accounting firms with expertise in Employee Retirement Income Security Act (ERISA) audits, common interest realty associations, and other industries that are similar to ours. We have implemented a plan for consultation with these firms for guidance in situations with which we are unfamiliar.

3. We have purchased practice aids that are specific to the industries of our clients and have instructed staff and partners on their use.

---

[fn 1] The response of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: To the National Peer Review Committee.

[fn 2] The response should use the singular *I, me,* and *my* only when the reviewed firm is a sole practitioner.

[fn 3] The numbering of responses, to coincide with the numbered comments in the report, is optional.

4. At the staff meeting previously mentioned, the importance of proper use of the firm's reporting and disclosure checklist was discussed, including the use of checklists for specialized industries. We discussed the proper resolution of points or topics unfamiliar to the individual completing the checklist or those reviewing its completion. The firm's CPE plan for partners and managers now includes annual updates on disclosure issues.

The firm is committed to strengthening its monitoring policies and procedures, especially as they relate to a timely post-issuance review of engagements. We have acquired quality control materials to guide the firm, and supervision of the monitoring process has been assigned to a partner. Additionally, outside assistance (as previously mentioned) has been sought, and this individual will be available for consultation and guidance.

Sincerely,

[*Name of Firm*] [fn 4]

## Appendix M

## Illustration of a Report With a Peer Review Rating of *Pass* in an Engagement Review

**.219**

In the event of a scope limitation, include an additional paragraph (as described in paragraph .122j of the standards), and follow the illustrations for System Reviews with scope limitations (see appendixes D, "Illustration of a Report With a Peer Review Rating of Pass (With a Scope Limitation) in a System Review;" G, "Illustration of a Report With a Peer Review Rating of Pass With Deficiencies (With a Scope Limitation) in a System Review;" and K, "Illustration of a Report With a Peer Review Rating of Fail (With a Scope Limitation) in a System Review").

[*Administering entity letterhead for a committee-appointed review team review; firm letterhead for a firm-on-firm review; review captain's firm letterhead for an association formed review team*]

**Engagement Review Report**

September 30, 20XX

To the Partners of [*or other appropriate terminology*] XYZ & Co. and the Peer Review Committee of the [*insert the name of the applicable administering entity*] [fn 1]

---

[fn 4] Signed by an authorized partner of the firm.

[fn 1] The report of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: To the Partners of [or appropriate terminology] XYZ & Co. and the National Peer Review Committee.

We [fn 2] have reviewed selected accounting engagements of XYZ & Co. (the firm) [fn 3] issued with periods ending during 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. 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. Our responsibility is to evaluate whether the engagements submitted for review were performed and reported on in conformity with applicable professional standards in all material respects. An Engagement Review does not include reviewing the firm's system of quality control and compliance therewith and, accordingly, we express no opinion or any form of assurance on that system. The nature, objectives, scope, limitations of, and the procedures performed in an Engagement Review are described in the standards at www.aicpa.org/prsummary.

Based on our review, nothing came to our attention that caused us to believe that the engagements submitted for review by XYZ & Co. [fn 4] issued with periods ending during the year ended June 30, 20XX, were not performed and reported on 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*.

Smith, Jones and Associates [*Name of review captain's firm on firm-on-firm review or association formed review team*]

[*or*]

John Brown, Review Captain

[*Committee-appointed review team review*]

## Appendix N

## Illustration of a Report With a Peer Review Rating of *Pass With Deficiencies* in an Engagement Review

**.220**

---

[fn 2] The report should use the plural *we*, *us*, and *our* even if the review team consists of only one person. The singular *I*, *me*, and *my* are appropriate only if the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

[fn 3] The report of a firm who is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

[fn 4] The report of a firm who is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

This illustration assumes the review captain concludes that deficiencies are not evident on all of the engagements submitted for review. Otherwise, this firm would have received a peer review rating of *fail*.

In the event of a scope limitation, include an additional paragraph (as described in paragraph .122j of the standards), and follow the illustrations for System Reviews with scope limitations (appendixes D, "Illustration of a Report With a Peer Review Rating of Pass (With a Scope Limitation) in a System Review;" G, "Illustration of a Report With a Peer Review Rating of Pass With Deficiencies (With a Scope Limitation) in a System Review;" and K, "Illustration of a Report With a Peer Review Rating of Fail (With a Scope Limitation) in a System Review").

[*Administering entity letterhead for a committee-appointed review team review; firm letterhead for a firm-on-firm review; review captain's firm letterhead for an association formed review team*]

**Engagement Review Report**

September 30, 20XX

To the Partners of [*or other appropriate terminology*] XYZ & Co. and the Peer Review Committee of the [*insert the name of the applicable administering entity*] [fn 1]

We [fn 2] have reviewed selected accounting engagements of XYZ & Co. (the firm) [fn 3] issued with periods ending during 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. 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. Our responsibility is to evaluate whether the engagements submitted for review were performed and reported on in conformity with applicable professional standards in all material respects. An Engagement Review does not include reviewing the firm's system of quality control and compliance therewith and, accordingly, we express no opinion or any form of assurance on that system. The nature, objectives, scope, limitations of, and the procedures performed in an Engagement Review are described in the standards at www.aicpa.org/prsummary.

---

[fn 1] The report of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: To the Partners of [or appropriate terminology] XYZ & Co. and the National Peer Review Committee.

[fn 2] The report should use the plural *we*, *us*, and *our* even if the review team consists of only one person. The singular *I*, *me*, and *my* are appropriate only if the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

[fn 3] The report of a firm who is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

We noted the following deficiencies [fn 4] during our review:

1. Deficiency—On one review engagement of a manufacturing client, we noted that the accompanying accountant's report was not appropriately modified. The financial statements did not appropriately present or disclose matters in accordance with industry standards. The firm discussed the departure with the client and decided to recall its report and restate the accompanying financial statements in order to report in conformity with applicable professional standards in all material respects.

   Recommendation—We recommend that the firm establish a means of ensuring that financial statements present or disclose matters in accordance with industry standards. Such means might include continuing professional education in the industries of the firm's engagements and, although not required by professional standards, use of a comprehensive reporting and disclosure checklist on accounting engagements that is tailored for specialized industries, where applicable, or a cold review of reports and financial statements prior to issuance.

2. Deficiency—On a review engagement we reviewed, we noted that the firm failed to obtain a management representation letter, and its working papers failed to document the matters covered in the accountant's inquiry and analytical procedures. These deficiencies were identified on the firm's previous review.

   Recommendation—The firm should review and implement the requirements for obtaining management representation letters and the content of the accountant's working papers on review engagements.

Based on our review, except for the deficiencies previously described, nothing came to our attention that caused us to believe that the engagements submitted for review by XYZ & Co. [fn 5] issued with periods ending during the year ended June 30, 20XX, were not performed and reported on 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 with deficiencies*.

Smith, Jones and Associates

[*Name of review captain's firm on firm-on-firm review or association formed review team*]

[*or*]

John Brown, Review Captain [*Committee-appointed review team review*]

## Appendix O

---

[fn 4] The deficiencies and related recommendations provided are examples provided for illustrative purposes only.

[fn 5] The report of a firm who is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

## Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Pass With Deficiencies* in an Engagement Review

**.221**

The purpose of a letter of response is to describe the actions the firm has taken or will take including the timing of the planned actions to prevent the recurrence of each deficiency discussed in the report. If the reviewed firm disagrees with one or more of the deficiencies or recommendations in the report, the reviewed firm should contact the administering entity for assistance in the matter. If the firm still disagrees after contacting the administering entity, the firm's response should describe the reasons for such disagreement. For additional guidance on disagreements, see paragraph .116 of standards. The letter of response should be carefully prepared because of the important bearing it may have on the decisions reached in connection with acceptance of the report on the review (see paragraphs .136–.140, "Accepting System and Engagement Reviews"). The letter of response should be submitted to the reviewer for review and comment prior to the firm submitting the response to the administering entity.

October 31, 20XX

[*Addressed to the peer review committee of the administering entity*] [fn 1]

Ladies and Gentlemen:

This letter represents our [fn 2] response to the report on the Engagement Review of our firm's accounting practice for engagements submitted for review with periods ending during the year ended June 30, 20XX.

1. [fn 3] As recommended by the reviewer, the entire staff has participated in continuing professional education related to reporting and disclosures, with a particular focus on areas specific to the industries that we are engaged in. We will be performing a pre-issuance review by a partner not associated with the engagement to make sure that the accountant's report is appropriately modified when the financial statements depart from applicable professional standards.

2. Management representation letters will be obtained for all future review engagements issued by the firm. The firm has required that a manager review each engagement to ensure that the management representation letter is obtained and that all the required documentation, including the

---

[fn 1] The response of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: To the National Peer Review Committee.

[fn 2] The response should use the singular *I, me,* and *my* only when the reviewed firm is a sole practitioner.

[fn 3] The numbering of responses, to coincide with the numbered comments in the report, is optional.

matters covered in the accountant's inquiry and analytical procedures, is included in the working papers.

We believe these actions address the matters noted by the reviewer.

Sincerely,

[*Name of firm*] [fn 4]

## Appendix P

## Illustration of a Report With a Peer Review Rating of *Fail* in an Engagement Review

**.222**

The deficiencies in this illustration represent various examples and are not intended to suggest that the peer review would include this many engagements in the scope or require this number of deficiencies to warrant a report with a peer review rating of *fail*. However, each of the engagements reviewed would have one or more deficiencies in a report with a peer review rating of *fail*.

In the event of a scope limitation, include an additional paragraph (as described in paragraph .122j of the standards), and follow the illustrations for System Reviews with scope limitations (appendixes D, "Illustration of a Report With a Peer Review Rating of Pass (With a Scope Limitation) in a System Review;" G, "Illustration of a Report With a Peer Review Rating of Pass With Deficiencies (With a Scope Limitation) in a System Review;" and K, "Illustration of a Report With a Peer Review Rating of Fail (With a Scope Limitation) in a System Review").

[*Administering entity letterhead for a committee-appointed review team review; firm letterhead for a firm-on-firm review; review captain's firm letterhead for an association formed review team*]

**Engagement Review Report**

September 30, 20XX

To the Partners of [*or other appropriate terminology*] XYZ & Co. and the Peer Review Committee of the [*insert the name of the applicable Administering Entity*] [fn 1]

We [fn 2] have reviewed selected accounting engagements of XYZ & Co. (the firm) [fn 3] issued with periods ending during the year ended June 30, 20XX. Our peer review was conducted in accordance with the

---

[fn 4] Signed by an authorized partner of the firm.

[fn 1] The report of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: To the Partners of [or appropriate terminology] XYZ & Co. and the National Peer Review Committee.

Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. 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. Our responsibility is to evaluate whether the engagements submitted for review were performed and reported on in conformity with applicable professional standards in all material respects. An Engagement Review does not include reviewing the firm's system of quality control and compliance therewith and, accordingly, we express no opinion or any form of assurance on that system. The nature, objectives, scope, limitations of, and the procedures performed in an Engagement Review are described in the standards at www.aicpa.org/prsummary.

We noted the following significant deficiencies [fn 4] during our review:

1. Deficiency—Our review disclosed several failures to adhere to applicable professional standards in reporting on material departures from generally accepted accounting principles (GAAP) and in conforming to standards for accounting and review services. Specifically, the firm did not disclose in certain compilation and review reports failures to conform with GAAP in accounting for leases, in accounting for revenue from construction contracts, and in disclosures made in the financial statements or the notes thereto concerning various matters important to an understanding of those statements. The compilation and review engagements were in the construction and manufacturing industries, respectively. In addition, the firm did not obtain management representation letters on review engagements.

   Recommendation—We recommend the firm establish a means of ensuring its conformity with applicable professional standards. In addition, we recommend the firm review and implement the requirements for obtaining management representation letters on review engagements. The firm should either participate in continuing professional education in financial statement disclosures, use a reporting and disclosure checklist on accounting engagements (tailored if the financial statements are in a specialized industry), or conduct a pre-issuance review of the engagement by an individual not associated with the engagement prior to issuance.

2. Deficiency—During our review, we noted the firm did not modify its compilation reports on financial statements when neither the financial statements nor the footnotes noted that the state-

---

[fn 2] The report should use the plural *we*, *us*, and *our* even if the review team consists of only one person. The singular *I*, *me*, and *my* are appropriate only if the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

[fn 3] The report of a firm who is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

[fn 4] The deficiencies and related recommendations provided are examples provided for illustrative purposes only.

ments were presented using a special purpose framework. [fn 5] This deficiency was noted in the firm's previous peer reviews.

Recommendation—We recommend that the firm review the reports issued during the last year and identify those reports that should have been modified to reflect the use of a special purpose framework. A memorandum should then be prepared highlighting the changes to be made in the current year and placed in the files of the client for whom a report must be changed.

3. Deficiency—In the construction industry compilation engagements that we reviewed, disclosures of material lease obligations as required by generally accepted accounting principles were not included in the financial statements, and the omissions were not disclosed in the accountant's reports.

   Recommendation—We recommend the firm review and disseminate information regarding the disclosure requirements on specialized industries to all staff involved in reviewing or compiling financial statements. In addition, we recommend that the firm establish appropriate policies to ensure that all lease obligations are disclosed in financial statements reported on by the firm. For example, a step might be added to compilation and review work programs requiring that special attention be given to these areas.

4. Deficiency—During our review of the financial statements for a compilation engagement prepared under Statement on Standards for Accounting and Review Services No. 8, for management use only, we noted that the engagement letter did not include all of the information required by applicable professional standards.

   Recommendation—The firm should review the professional standards governing the information to be included in engagement letters for financial statements prepared for management use only and make sure it conforms to those standards.

As a result of the deficiencies previously described, we believe that the engagements submitted for review by XYZ & Co. [fn 6] issued with periods ending during the year ended June 30, 20XX, were not performed and reported on 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 *fail*.

Smith, Jones and Associates

[*Name of review captain's firm on firm-on-firm review or association formed review team*]

---

[fn 5] The cash, tax, regulatory, and other bases of accounting that utilize a definite set of logical, reasonable criteria that are applied to all material items appearing in financial statements are commonly referred to as other comprehensive bases of accounting.

[fn 6] The report of a firm who is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

[*or*]

John Brown, Review Captain [*Committee-appointed review team review*]

## Appendix Q

## Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Fail* in an Engagement Review

**.223**

The purpose of a letter of response is to describe the actions the firm has taken or will take including the timing of the planned actions to prevent the recurrence of each of the significant deficiencies. If the reviewed firm disagrees with one or more of the significant deficiencies or recommendations in the report, the reviewed firm should contact the administering entity for assistance. If the firm still disagrees after contacting the administering entity, the firm's response should describe the reasons for such disagreement. For additional guidance on disagreements, see paragraph .116 of the standards. The letter of response should be carefully prepared because of the important bearing it may have on the decisions reached in connection with acceptance of the report on the review (see paragraphs .136–.140, "Accepting System and Engagement Reviews"). The letter of response should be submitted to the reviewer for review and comment prior to the firm submitting the response to the administering entity.

October 31, 20XX

[*Addressed to the peer review committee of the administering entity*] [fn 1]

Ladies and Gentlemen:

This letter represents our [fn 2] response to the report on the Engagement Review of our firm's accounting practice for engagements submitted for review with periods ending during the year ended June 30, 20XX.

[fn 3] To prevent the recurrence of the deficiencies noted by the reviewer and to prevent other such deficiencies from occurring, we will review the professional standards related to the deficiencies and ensure that the professional standards will be complied with on all future engagements.

---

[fn 1] The response of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: To the National Peer Review Committee.

[fn 2] The response should use the singular *I, me,* and *my* only when the reviewed firm is a sole practitioner.

[fn 3] The numbering of responses, to coincide with the numbered comments in the report, is optional.

Specifically, we have strengthened the engagement review to ensure that management representation letters are obtained for all review engagements performed by the firm.

All personnel who work on accounting engagements will be participating in continuing professional education in disclosures and reporting by December 31, 20XX, to address the disclosure and reporting deficiencies noted by the reviewer. In addition, we have started using a third-party reporting and disclosure checklist to ensure all reporting and disclosure matters are appropriately addressed. The reporting and disclosure checklist is tailored to specialized industries, where applicable.

The firm is now using third-party practice aids for guidance in compilations of financial statements for management use only, and this includes engagement letters that conform to professional standards to document the client's understanding with respect to these engagements. We believe these actions are responsive to the deficiencies noted on the review.

Sincerely,

[*Name of firm*] [fn 4]

## Appendix R

## Illustration of a Report With a Review Rating of *Pass* in a Review of Quality Control Materials

**.224**

**Quality Control Materials Review Report**

April 30, 20XX

Executive Board of XYZ Organization and the National Peer Review Committee

We have reviewed the system of quality control for the development and maintenance of [*identify each item covered by the opinion or refer to an attached listing*] (hereafter referred to as *materials*) of XYZ Organization (the provider) and the resultant materials in effect at December 31, 20XX. Our quality control materials 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. The provider is responsible for designing and complying with a system of quality control that provides reasonable assurance that the materials are reliable aids to assist users in conforming with the components which are integral to the professional standards that the materials purport to encompass. Our responsibility is to express an opinion on the design of the system, the provider's compliance with that system, and the reliability of the resultant materials, based on our review. The nature, objectives, scope, limitations of, and the procedures performed in a Quality Control Materials Review are described in the standards at www.aicpa.org/prsummary.

[fn 4] Signed by an authorized partner of the firm.

Users of the materials and this report should carefully consider the scope of this review. They should also understand the intended uses and limitations of the materials as reflected in their user instructions and related information, as well as the level of explanatory guidance provided by the materials. Users of the materials are responsible for evaluating their suitability and implementing, tailoring, and augmenting the materials as appropriate. Therefore, the reliability of the materials is also dependent on the effectiveness of these actions and could vary from user to user. Further, there may be important elements of a quality control system in accordance with the Statements on Quality Control Standards that are not included in the materials that have been subject to this review.

In our opinion, the system of quality control for the development and maintenance of the quality control materials of the XYZ Organization was suitably designed and was being complied with during the year ended December 31, 20XX, to provide users of the materials with reasonable assurance that the materials are reliable aids. Also, in our opinion, the quality control materials previously referred to are reliable aids to assist users in conforming with the components which are integral to the professional standards the materials purport to encompass at December 31, 20XX. Providers can receive a rating of *pass*, *pass with deficiency(ies*), or *fail*. XYZ Organization has received a review rating of *pass*.

ABC & Co. [fn 1]

## Appendix S

## Illustration of a Report With a Review Rating of *Pass With Deficiencies* in a Review of Quality Control Materials

**.225**

**Quality Control Materials Review Report**

April 30, 20XX

Executive Board of XYZ Organization and the National Peer Review Committee

We have reviewed the system of quality control for the development and maintenance of [*identify each item covered by the opinion or refer to an attached listing*] (hereafter referred to as *materials*) of XYZ Organization (the provider) and the resultant materials in effect at December 31, 20XX. Our quality control materials 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. The provider is responsible for designing and complying with a system of quality control that provides reasonable assurance that the materials are reliable aids to assist users in conforming with the components which are integral to the professional standards that the materials purport to encompass. Our responsibility is to express an opinion on the design of the system, the provider's compliance with that system, and the reliability of the resultant materials, based on our review. The nature, objectives,

[fn 1] The report should be signed in the name of the team captain's firm for firm-on-firm reviews or association formed review teams.

scope, limitations of, and the procedures performed in a Quality Control Materials Review are described in the standards at www.aicpa.org/prsummary.

Users of the materials and this report should carefully consider the scope of this review. They should also understand the intended uses and limitations of the materials as reflected in their user instructions and related information, as well as the level of explanatory guidance provided by the materials. Users of the materials are responsible for evaluating their suitability and implementing, tailoring, and augmenting the materials as appropriate. Therefore, the reliability of the materials is also dependent on the effectiveness of these actions and could vary from user to user. Further, there may be important elements of a quality control system in accordance with the Statements on Quality Control Standards that are not included in the materials that have been subject to this review.

We noted the following deficiencies [fn 1] during our review:

1. Deficiency—The provider's policies and procedures for the development and maintenance of quality control materials state that feedback on the materials is obtained by means of a questionnaire provided with the materials. The provider's policies and procedures do not specify the procedures to be followed for reviewing and analyzing returned questionnaires. As a result, our review of the questionnaires received by the provider during the review period indicated that several questionnaires that had significant feedback as to the accuracy of the information of certain materials were not being read, summarized, or analyzed to determine whether the quality control materials require change. During our review we noted an error in the provider's interpretation of a recently issued professional standard in the *How To Perform Employee Benefit Plan Audits* manual. This error was also noted on several of the feedback questionnaires. However, the error was not of such significance that it affected the reliability of the aid. Our review did not note any similar issues in the other materials.

   Recommendation—The provider should revise its policies and procedures to include procedures for reviewing, summarizing, and analyzing the feedback received on its quality control materials in order to determine whether the materials require change(s) to provide reasonable assurance that the materials are reliable aids. In addition, the provider may wish to consider using external technical reviewers to confirm its understanding of new professional standards.

2. Deficiency—The organization's policies and procedures require that a technical review of all quality control materials be performed by a qualified person other than the developer to ensure that the materials are reliable aids to assist users in conforming to those professional standards the materials purport to encompass. During our review, we noted that such a technical review was performed on all of the materials we reviewed except for the current edition of the General Financial Statement Disclosure and Reporting checklist, Construction Contractor Disclosure checklist, and the Personal Financial Statements checklist, which had cold reviews performed by the developer. However, we were satisfied that the checklists are reliable aids.

---

[fn 1] The deficiencies and related recommendations provided are examples provided for illustrative purposes only.

Recommendation—The organization should remind its personnel of the importance of complying with its technical review policy. In addition, the organization may wish to implement other controls to ensure compliance with this policy.

In our opinion, except for the deficiencies previously described, the system of quality control for the development and maintenance of the quality control materials of the XYZ Organization was suitably designed and was being complied with during the year ended December 31, 20XX, to provide users of the materials with reasonable assurance that the materials are reliable aids. Also, in our opinion, the quality control materials previously referred to are reliable aids to assist users in conforming with the components which are integral to the professional standards the materials purport to encompass at December 31, 20XX. Providers can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ Organization has received a review rating of *pass with deficiencies*.

ABC & Co. [fn 2]

## Appendix T

## Illustration of a Report With a Review Rating of *Fail* in a Review of Quality Control Materials

**.226**

The deficiencies and related recommendations provided are examples for illustrative purposes only. Any one or more of the deficiencies, based on the relative importance of the deficiency to the system of quality control as a whole, could result in a report with a peer review rating of *fail*.

**Quality Control Materials Review Report**

October 31, 20XX

Executive Board of XYZ Organization and the National Peer Review Committee

We have reviewed the system of quality control for the development and maintenance of [*identify each item covered by the opinion or refer to an attached listing*] (hereafter referred to as *materials*) of XYZ Organization (the provider) and the resultant materials in effect at December 31, 20XX. Our quality control materials 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. The provider is responsible for designing and complying with a system of quality control that provides reasonable assurance that the materials are reliable aids to assist users in conforming with the components which are integral to the professional standards that the materials purport to encompass. Our responsibility is to express an opinion on the design of the system, the provider's compliance with that system, and the reliability of the resultant materials, based on our review. The nature, objectives, scope, limitations of, and the procedures performed in a Quality Control Materials Review are described in the standards at www.aicpa.org/prsummary.

---

[fn 2] The report should be signed in the name of the team captain's firm for firm-on-firm reviews or association formed review teams.

Users of the materials and this report should carefully consider the scope of this review. They should also understand the intended uses and limitations of the materials as reflected in their user instructions and related information, as well as the level of explanatory guidance provided by the materials. Users of the materials are responsible for evaluating their suitability and implementing, tailoring, and augmenting the materials as appropriate. Therefore the reliability of the materials is also dependent on the effectiveness of these actions and could vary from user to user. Further, there may be important elements of a quality control system in accordance with the Statements on Quality Control Standards that are not included in the materials that have been subject to this review.

We noted the following significant deficiencies [fn 1] during our review:

1. Deficiency—The organization's policies and procedures for the development and maintenance of quality control materials state that feedback on the materials is obtained by means of a questionnaire provided with the materials. The organization's policies and procedures do not specify the procedures to be followed for reviewing and analyzing returned questionnaires. As a result, our review of the questionnaires received by the organization during the review period indicated that several questionnaires that had significant feedback as to the accuracy of the information of certain materials were not being read, summarized, or analyzed to determine whether the quality control materials require change. During our review we noted errors in the provider's interpretation of recently issued professional standards in the *How To Perform Employee Benefit Plan Audits*, *How To Perform Audits of Small Businesses* and *How To Perform Construction Contractor Reviews* manuals. The errors were identified on several of the feedback questionnaires. As a result, these specific materials were inaccurate and, thus, were not reliable aids.

   Recommendation—The organization should revise its policies and procedures to include procedures for reviewing, summarizing, and analyzing the feedback received on its quality control materials in order to determine whether the materials require change(s) to provide reasonable assurance that the materials are reliable aids. In addition, the provider may wish to consider using external technical reviewers to confirm its understanding of new professional standards.

2. Deficiency—The organization's policies and procedures require that a technical review of all quality control materials be performed by a qualified person other than the developer to ensure that the materials are reliable aids to assist users in conforming to the professional standards the materials purport to encompass. During our review, we noted that such a technical review was not performed on the *How To Perform Single Audits* and *How To Perform HUD Audits* manuals. As a result, these materials were not up-to-date or were inaccurate, and thus were not reliable aids.

   Recommendation—The organization should remind its personnel of the importance of complying with its technical review policy. In addition, the organization may wish to implement other controls to ensure compliance with this policy.

In our opinion, as a result of the deficiencies previously described, the system of quality control for the development and maintenance of the quality control materials of XYZ Organization was not suitably de-

---

[fn 1] When considered together, the deficiencies rise to the level of significant deficiencies.

signed or complied with during the year ended December 31, 20XX, to provide the users of the materials with reasonable assurance that the materials are reliable aids. Also, in our opinion, the quality control materials previously referred to are not reliable aids and do not assist users in conforming with the components which are integral to the professional standards the materials purport to encompass at December 31, 20XX. Providers can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ Organization has received a review rating of *fail*.

ABC & Co. [fn 2]

[fn 2] The report should be signed in the name of the team captain's firm for firm-on-firm reviews or association formed review teams.