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Interactive Self-study CPE

Companion to PPC's Guide to Quality Control

TABLE OF CONTENTS

	Page
COURSE 1: THE BASICS OF QUALITY CONTROL, THE PEER REVIEW PROCESS, AND UNDERGOING A SYSTEM REVIEW	
Overview	1
Lesson 1: The Basics of Quality Control	3
Lesson 2: The Peer Review Process and Undergoing a System Review	25
Examination for CPE Credit	101
Glossary	111
Index	115
COURSE 2: CLIENT ACCEPTANCE AND CONTINUANCE AND HUMAN RESOURCES	
Overview	117
Lesson 1: Acceptance and Continuance of Client Relationships and Specific Engagements	119
Lesson 2: Human Resources	163
Examination for CPE Credit	223
Glossary	235
Index	237
ANSWER SHEETS AND EVALUATIONS	
Course 1: Examination for CPE Credit Answer Sheet	239
Course 1: Self-study Course Evaluation	240
Course 2: Examination for CPE Credit Answer Sheet	241
Course 2: Self-study Course Evaluation	242

INTRODUCTION

Companion to PPC's Guide to Quality Control consists of two interactive self-study CPE courses. These are companion courses to *PPC's Guide to Quality Control* designed by our editors to enhance your understanding of the latest issues in the field. *PPC's Guide to Quality Control* and other PPC products are available for purchase at **tax.tr.com/ppcguidance**.

To obtain credit for this course, you must complete the learning process by logging on to our Online Grading System at **cl.tr.com/ogs** or by mailing or faxing your completed **Examination for CPE Credit Answer Sheet** for print grading by **April 30, 2019**. Complete instructions for grading are included below and in the Test Instructions preceding the Examination for CPE Credit.

Taking the Courses

Each course is divided into lessons. Each lesson addresses an aspect of quality control. You are asked to read the material and, during the course, to test your comprehension of each of the learning objectives by answering self-study quiz questions. After completing each quiz, you can evaluate your progress by comparing your answers to both the correct and incorrect answers and the reason for each. References are also cited so you can go back to the text where the topic is discussed in detail. Once you are satisfied that you understand the material, **answer the examination questions at the end of the course**. You may record your answer choices by printing the **Examination for CPE Credit Answer Sheet** or by logging on to our Online Grading System.

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Checkpoint Learning is registered with the National Association of State Boards of Accountancy (NASBA) as a sponsor of continuing education on the National Registry of CPE Sponsors. State boards of accountancy have final authority on the acceptance of individual courses for CPE credit. Complaints regarding registered sponsors may be submitted to the National Registry of CPE Sponsors through its website: **www.nasbaregistry.org**.

Checkpoint Learning is also approved for "QAS Self Study" designation.

The requirements for NASBA Registry membership include conformance with the *Statement on Standards of Continuing Professional Education (CPE) Programs* (the *Standards*), issued jointly by NASBA and the AICPA. As of this date, not all boards of public accountancy have adopted the *Standards* in their entirety. Each course is designed to comply with the *Standards*. For states that have adopted the *Standards*, credit hours are measured in 50-minute contact hours. Some states, however, may still require 100-minute contact hours for self study. Your state licensing board has final authority on acceptance of NASBA Registry QAS self-study credit hours. Check with your state board of accountancy to confirm acceptability of NASBA QAS self-study credit hours. Alternatively, you may visit the NASBA website at **www.nasbaregistry.org** for a listing of states that accept NASBA QAS self-study credit hours and that have adopted the *Standards*. Credit hours for CPE courses vary in length. Credit hours for each course are listed on the **Overview** page before each course.

CPE requirements are established by each state. You should check with your state board of accountancy to determine the acceptability of this course. We have been informed by the North Carolina State Board of Certified Public Accountant Examiners and the Mississippi State Board of Public Accountancy that they will not allow credit for courses included in books or periodicals.

Obtaining CPE Credit

Online Grading. Log onto our Online Grading Center at **cl.thomsonreuters.com/ogs** to receive instant CPE credit. Click the purchase link and a list of exams will appear. You may search for the exam using wildcards. Payment for the exam of $95 is accepted over a secure site using your credit card. For further instructions regarding the Online Grading Center, please refer to the Test Instructions preceding the **Examination for CPE Credit**. A certificate documenting the CPE credits will be issued for each examination score of 70% or higher.

Print Grading. You can receive CPE credit by emailing, mailing, or faxing your completed **Examination for CPE Credit Answer Sheet** to Thomson Reuters (Tax & Accounting) Inc. for grading. Answer sheets are located at the end of the course PDFs. They may be printed from electronic products; they can also be scanned for email grading, if desired. The answer sheet is identified with the course acronym. Please ensure you use the correct answer sheet for each course. Payment (by check or credit card) must accompany each answer sheet submitted. We cannot process answer sheets that do not include payment. Payment for emailed or faxed answer sheets is $95. There is an additional $10 charge for manual print grading, so please include a total of $105 with answer sheets sent by regular mail. Please take a few minutes to complete the **Self-study Course Evaluation** so that we can provide you with the best possible CPE.

You may fax your completed **Examination for CPE Credit Answer Sheet** and **Self-study Course Evaluation** to **(888) 286-9070** or email them to *CPLGrading@thomsonreuters.com*. The mailing address is provided on the Overview and Exam Instructions pages.

If more than one person wants to complete this self-study course, each person should complete a separate **Examination for CPE Credit Answer Sheet.** Payment must accompany each answer sheet submitted ($95 when sent by email or fax; $105 when sent by regular mail). We would also appreciate a separate **Self-study Course Evaluation** from each person who completes an examination.

Retaining CPE Records

For all scores of 70% or higher, you will receive a *Certificate of Completion.* You should retain it and a copy of these materials for at least five years.

COMPANION TO PPC'S GUIDE TO QUALITY CONTROL

COURSE 1

THE BASICS OF QUALITY CONTROL, THE PEER REVIEW PROCESS, AND UNDERGOING A SYSTEM REVIEW (GQCTG181)

OVERVIEW

COURSE DESCRIPTION: This interactive self-study course discusses aspects of quality control and peer review. Lesson 1 provides an introduction to the concept of quality control and how firms can create a quality control (QC) system. Lesson 2 discusses the peer review process as a whole and takes an in-depth look at system reviews.

PUBLICATION/REVISION DATE: April 2018

RECOMMENDED FOR: Users of *PPC's Guide to Quality Control*

PREREQUISITE/ADVANCE PREPARATION: Basic knowledge of accounting and auditing

CPE CREDIT: 8 NASBA Registry "QAS Self-Study" Hours

This course is designed to meet the requirements of the *Statement on Standards of Continuing Professional Education (CPE) Programs* (the *Standards*), issued jointly by NASBA and the AICPA. As of this date, not all boards of public accountancy have adopted the *Standards* in their entirety. For states that have adopted the *Standards*, credit hours are measured in 50-minute contact hours. Some states, however, may still require 100-minute contact hours for self study. Your state licensing board has final authority on acceptance of NASBA Registry QAS self-study credit hours. Check with your state board of accountancy to confirm acceptability of NASBA QAS self-study credit hours. Alternatively, you may visit the NASBA website at **www.nasbaregistry.org** for a listing of states that accept NASBA QAS self-study credit hours and that have adopted the *Standards*.

FIELD OF STUDY: Business Management & Organization

EXPIRATION DATE: Postmark by **April 30, 2019**

KNOWLEDGE LEVEL: Basic

Learning Objectives:

Lesson 1—The Basics of Quality Control

Completion of this lesson will enable you to:
- Identify the purpose of quality control, the requirements of SQCS No. 8, and other engagement level QC requirements.
- Determine how a firm can demonstrate a commitment to quality, develop and implement an effective QC system, draft its QC policies and procedures, and maintain its QC system.

Lesson 2—The Peer Review Process and Undergoing a System Review

Completion of this lesson will enable you to:
- Identify the evolution of the peer review process over time, the benefits of undergoing peer review, and the elements of the AICPA Peer Review Program.
- Identify the planning activities that are necessary prior to a system review.
- Recognize what to expect during a system review.
- Identify the post-fieldwork activities that occur during a system review, how the review is accepted, how disagreements are resolved, and the applicable documentation and retention requirements.

TO COMPLETE THIS LEARNING PROCESS:

Log onto our Online Grading Center at **cl.tr.com/ogs.** Online grading allows you to get instant CPE credit for your exam.

Alternatively, you can submit your completed **Examination for CPE Credit Answer Sheet, Self-study Course Evaluation,** and payment via one of the following methods:

- Email to: *CPLGrading@thomsonreuters.com*
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GQCTG181 Self-study CPE
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See the test instructions included with the course materials for additional instructions and payment information.

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For information regarding refunds and complaint resolutions, dial (800) 431-9025 for Customer Service and your questions or concerns will be promptly addressed.

Lesson 1: The Basics of Quality Control

INTRODUCTION

Quality. A simple, yet powerful word. The *American Heritage Dictionary* defines *quality* as a "degree or grade of excellence." For a CPA firm, the performance of high-quality professional services is essential to ensuring the firm's success, profitability, and longevity. A firm's system of quality control is the bedrock on which its accounting and auditing practice is based. It provides a structure for performing engagement procedures and a safety net for helping to ensure that the firm's reports are appropriate in the circumstances. An effective quality control system reflects a firm's commitment to quality at all levels, which usually results in high-quality services.

Learning Objectives:

Completion of this lesson will enable you to:

- Identify the purpose of quality control, the requirements of SQCS No. 8, and other engagement level QC requirements.
- Determine how a firm can demonstrate a commitment to quality, develop and implement an effective QC system, draft its QC policies and procedures, and maintain its QC system.

What Is Quality Control?

The AICPA *Code of Professional Conduct* (the Code) requires members to practice in firms that implement and maintain quality control procedures to ensure that services delivered to clients are competently performed and adequately supervised. Statements on Quality Control Standards (SQCSs) are standards issued by the AICPA Auditing Standards Board to provide the framework for developing and maintaining an effective system of quality control. Firms that have accounting and auditing practices are required to follow the quality control (QC) standards. SQCS No. 8, *A Firm's System of Quality Control* (QC 10), establishes the authoritative guidance over a firm's system of quality control and is further discussed later in this lesson.

What Is an Accounting and Auditing Practice? QC 10.13 defines an *accounting and auditing practice* as a practice that performs audit, attestation, compilation, review, and any other services for which standards have been established by the AICPA Auditing Standards Board (ASB) or the AICPA Accounting and Review Services Committee (ARSC) under the *General Standards Rule* (ET 1.300.001) and the *Compliance with Standards Rule* (ET 1.310.001) of the Code. (Lesson 2 discusses how the Peer Review Standards define *accounting and auditing practice*.) Thus, quality control standards apply to virtually all accounting and auditing services covered by AICPA pronouncements, including the SSARS, attestation, and auditing standards. (Throughout this course the use of the terms *accounting and auditing practice* and *accounting and auditing services* will be used interchangeably.) Engagements performed in accordance with standards established by *other* AICPA technical committees are not considered to be accounting and auditing services. For example, quality control standards do not apply to consulting services or valuation services because standards for those services are not established by the ASB or ARSC.

Specifically, the services that are included in a firm's accounting and auditing practice are as follows:

- Services covered by the auditing standards and *Government Auditing Standards*.
- Services covered by the SSARS—
  - Compilation engagements, including pro formas, forecasts, and projections.
  - Review engagements.
  - Preparation engagements, (as discussed in SSARS No. 21) including pro formas, forecasts, and projections.
- Services covered by the SSAEs, including
  - Reviews.

- Agreed-upon procedures engagements, including engagements to apply agreed-upon procedures to specified elements, accounts, or items of a financial statement. Agreed-upon procedures may apply to historical or prospective information.

- Examinations, including forecasts and projections.

- Reporting on controls at a service organization.

What Is the Purpose of a Quality Control System?

The purpose of a quality control system is to promote quality in performing accounting and auditing engagements. QC 10 indicates that a firm's system of quality control is a system designed to provide the firm with reasonable assurance that (a) the firm and its personnel are complying with professional standards and applicable legal and regulatory requirements and (b) that reports issued by the firm are appropriate in the circumstances. In developing and maintaining its quality control system, a firm should establish—

- policies designed to achieve the objectives associated with obtaining reasonable assurance and

- procedures to implement and monitor compliance with those policies.

Whom Is This Course Designed for?

All AICPA member firms with an accounting and auditing practice as defined by the Code are required to have a system of quality control. All such firms are also required to have a peer review performed every three years, as explained in Lesson 2. The types of engagements performed by an accounting and auditing practice firm determine whether the firm is subject to a system review or an engagement review for its required triennial peer review. This course has been designed for firms that are subject to system reviews.

Firms that are subject to engagement reviews may not find this course as helpful. *PPC's Guide to Quality Control—Compilation and Review* would be an effective resource for this type of firm.

Use of the Term *Partner*

This course often uses the term *partner* (for example, partner, engagement partner, or managing partner). For firms structured in legal forms other than partnerships (such as professional corporations and limited liability partnerships), this term is meant to be viewed as interchangeable with *shareholder* or *member*. Use of the term *partner* is not intended to imply that the firm is operating as a partnership.

SQCS NO. 8 AND OTHER ENGAGEMENT LEVEL QC REQUIREMENTS

Evolution of the Quality Control Standards

In 2007, the ASB issued Statement on Quality Control Standard No. 7, *A Firm's System of Quality Control*, which superseded and replaced all of the quality control standards that existed at the time. SQCS No. 7 established standards and provided guidance for a CPA firm's responsibilities for its system of quality control over its accounting and auditing practice, effective for a firm's system of quality control as of January 1, 2009. In 2010, the ASB issued Statement on Quality Control Standard No. 8, *A Firm's System of Quality Control (Redrafted)*, which superseded SQCS No. 7 and was applicable to a CPA firm's system of quality control for its accounting and auditing practice as of January 1, 2012.

In 2011, the ASB reissued SQCS No. 8, *A Firm's System of Quality Control*, incorporating conforming changes resulting from the issuance of SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification*. Those conforming changes did not revise any of the existing SQCS No. 8 (QC 10) guidance, but added cross-references to relevant AU-C sections. AU-C 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, issued as part of SAS No. 122, provides engagement-level quality control requirements for audits. AR-C 60*, General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*, issued as part of SSARS No. 21, provides engagement-level quality control requirements for engagements performed under the SSARS. AT-C 105, *Concepts Common to All Attestation Engagements*, issued as part of SSAE No. 18, provides concepts that apply to all attestation engagements, including quality control related considerations. This course incorporates the requirements of QC 10, and the engagement-level quality control requirements of AU-C 220, AR-C 60, and AT-C 105 (discussed later in this lesson).

As mentioned at the beginning of this lesson, the firm's system of quality control is a system designed to provide the firm with reasonable assurance that (a) the firm and its personnel are complying with professional standards and applicable legal and regulatory requirements and (b) that reports issued by the firm are appropriate in the circumstances. That statement is the objective of QC 10. Additionally, QC 10.17 indicates that the firm *must* establish and maintain a system of quality control.

The firm's quality control system should consist of policies and procedures. The nature of the policies and procedures the firm develops to obtain reasonable assurance and comply with the requirements of QC 10 will depend on various factors, such as the following:

- The size of the firm.
- The operating characteristics of the firm, for example:
  - Types of services provided.
  - Types of industries served.
  - Number of partners.
  - Number of professional personnel.
  - Number of offices.
  - Whether any firm engagements are partially performed by foreign affiliate firms.
  - Whether the firm is part of a network. (This course does not generally address the unique situations that affect network firms.)

Professional Requirements

QC 10.08 establishes two categories of professional requirements to describe the degree of responsibility the firm has for complying with the requirements of the QC standard. Those categories are—

- *Unconditional Requirements.* Unconditional requirements are those the firm must follow in all cases if the circumstances apply to the requirement. These requirements use the word *must*.
- *Presumptively Mandatory Requirements.* Firms are also expected to comply with presumptively mandatory requirements if the circumstances apply to the requirement; however, in rare situations, a departure from the requirement is allowed if the firm documents the justification and how alternative procedures that were performed were sufficient to achieve the objectives of the requirement. Presumptively mandatory requirements are identified by the word *should*. If the standard uses the words *should consider* for a procedure, the consideration of the procedure is presumptively required.

This course uses the terms *must* and *should* in accordance with QC 10.08. The term *is required* is used interchangeably with *should*.

The application and other explanatory material provides additional guidance on professional requirements or identifies other procedures or actions. While a firm is not required to perform the other procedures or actions, the information is relevant to the proper application of the requirements. The words *may*, *might*, and *could*, among others, are used to describe these actions and procedures. The application and other explanatory material may—

- Explain in more detail what a requirement means or is intended to cover.

- Include examples of policies and procedures that might be appropriate in the circumstances.

- Provide background information on matters addressed in the standard.

Definition of Terms

Before there can be a meaningful discussion of how to establish and maintain an effective quality control system governing a firm's accounting and auditing practice, there needs to be a clear understanding of what the relevant terms in the standard mean. The glossary at the end of this course includes a list of definitions from SQCS No. 8, as well as other terms that may be helpful during this discussion of quality control, the peer review process, and system reviews.

Elements of a Quality Control System

QC 10.17 states that the firm's system of quality control should incorporate policies and procedures that address each of the following QC elements:

- Leadership responsibilities for quality within the firm (*tone at the top*).

- Relevant ethical requirements.

- Acceptance and continuance of client relationships and specific engagements.

- Human resources.

- Engagement performance.

- Monitoring.

Exhibit 1-1 presents a brief description of the QC elements in QC 10, along with how each element contributes to the objective of obtaining reasonable assurance regarding the effectiveness of the QC system.

Documentation and Communication of the Firm's QC Policies and Procedures

QC 10.18 requires that the firm document its QC policies and procedures. Matters such as the nature of the firm's practice, its size, and its structure may be considered in determining the *extent* of documentation of the firm's QC policies and procedures. Documentation of the policies and procedures for a single-office firm with a small number of partners and staff would not be expected to be as extensive as those of a large, multi-office firm.

It is interesting to note that QC 10 does not require the firm to have a formal quality control policies and procedures *document*; instead, the standard indicates only that the firm's QC policies and procedures be *documented*. Thus, the standard allows the firm flexibility and latitude in determining the documentation method that best suits its individual practice and circumstances. (The use of the phrase *QC document* in this course is not meant to imply that firms need to document their policies and procedures in any particular manner.)

In reality though, having a quality control policies and procedures document reflecting the firm's structure and operations is expected by the AICPA. The questionnaires used by reviewers during the course of peer review specifically state that the comprehensive QC document used by the firm that was effective for the *peer review year* should be provided to the reviewer. That is, the firm is expected to provide to the peer reviewer a QC document that has been followed and adhered to operationally by the firm, not a document prepared solely for peer review purposes.

Exhibit 1-1

The Elements of Quality Control in QC 10

QC Element	Designed to Provide Reasonable Assurance That:
Leadership Responsibilities for Quality Within the Firm (*Tone at the Top*)	The firm establishes policies and procedures to promote an internal culture that is based on the recognition that quality is essential in performing engagements.
Relevant Ethical Requirements	The firm and its personnel comply with relevant ethical requirements.
Acceptance and Continuance of Client Relationships and Specific Engagements	The firm undertakes or continues only client relationships and engagements in which the firm (a) considers the client's integrity and does not have information that would indicate the client lacks integrity; (b) determines the firm has the competence, capabilities, and resources to perform the engagement; and (c) determines the firm can comply with applicable legal and regulatory requirements.
Human Resources	The firm has sufficient personnel with the competence, capabilities, and commitment to ethical principles to (a) perform engagements in accordance with professional standards and applicable legal and regulatory requirements, and (b) enable the firm to issue reports that are appropriate in the circumstances.
Engagement Performance	Work performed by engagement personnel consistently complies with professional standards and applicable legal and regulatory requirements, and the firm issues reports that are appropriate in the circumstances.
Monitoring	The policies and procedures established by the firm for the other elements of quality control are relevant, adequate, and operating effectively.

*   *   *

The six elements of quality control are separate, with each one providing specific requirements; but the elements are also interrelated. For example, the policies and procedures established by the firm for acceptance and continuance of client relationships and engagements relies heavily on assessing client relationships to ensure compliance with the relevant ethical requirements of independence, integrity, and objectivity. Additionally, the policies and procedures established by the firm to ensure compliance with the requirements of the human resources element and activities (such as professional development, hiring, advancement, and assignment of firm personnel to engagements) affect the engagement performance element. That being said, the policies and procedures that a firm establishes for each element should be designed to achieve reasonable assurance that the purpose of the particular element will be achieved.

In addition to documenting its QC policies and procedures, QC 10.18 indicates that the firm should communicate its QC policies and procedures to firm personnel. That communication is not required to be in writing, although written communication is preferable. Firm communication of its QC policies and procedures, as described in QC 10.A2, generally incorporates the following:

- A description of the policies and procedures and the objectives they achieve.
- A message that each person is responsible for maintaining quality, as well as being familiar with the policies and procedures and complying with them.
- Comments stressing the importance of receiving feedback on how the QC system is operating and encouraging staff to communicate their concerns on quality control issues.

One way to communicate the firm's policies and procedures to firm personnel is through a training session. Conducting annual "refresher" training also helps ensure that firm personnel stay knowledgeable on the firm's QC policies and procedures. The training could be provided during a regularly scheduled staff meeting or a separate in-house training session. It is important that all personnel hear the same message about the firm's QC policies and procedures. The AICPA has provided a PowerPoint template that firms may customize and use to conduct such training. The template is available as part of the AICPA's "Invigorate the Focus on Quality Toolkit," at **https://www.aicpa.org/interestareas/privatecompaniespracticesection/qualityservicesdelivery/keepingup/invigorate-the-focus.html**. Additionally, this material provides an attendance and acknowledgment form that may be used in conjunction with conducting an in-house training session on the firm's system of quality control and the related QC policies and procedures.

The documentation and communication requirement is applicable to firms that provide accounting and auditing services and requires those firms to undergo a peer review at least once every three years. As a result, firms that provide such services should have in place a quality control system that will withstand such a review or risk termination of firm membership in the program, individual memberships in the AICPA, and loss of their state licenses to practice.

Documentation Requirements

QC 10 includes general documentation requirements as well as various requirements to prepare and maintain documentation related to specific QC element areas. Specific information about documentation related to each element of quality control is beyond the scope of this course, but more information can be found in *PPC's Guide to Quality Control*.

Quality Control Auditing Standard (AU-C 220)

AU-C 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, provides requirements and guidance to the auditor and engagement partner as they implement each element of quality control during the performance of an audit of financial statements. Thus, for every quality control element discussed in QC 10, AU-C 220 provides information that conveys how the firm ensures that the requirements of the QC standard are met in an audit engagement. The responsibility to ensure compliance with AU-C 220 is primarily placed on the audit engagement partner. However, certain requirements are also imposed on the engagement team and, if applicable, engagement quality control reviewer. In meeting the requirements of AU-C 220, the engagement partner is permitted to delegate his or her responsibilities, and the engagement team may rely on the firm's quality control system unless the engagement partner has indicated that it is inappropriate to do so.

The objective of AU-C 220 indicates that the auditor should implement quality control procedures at the engagement level that provide him or her with reasonable assurance that (a) the audit complies with professional standards and applicable legal and regulatory requirements and (b) the auditor's report is appropriate in the circumstances.

The guidance in AU-C 220.04–.05 indicates that engagement teams are responsible to implement quality control procedures that apply to the audit engagement. Additionally, engagement teams are expected to provide the firm with relevant information needed to enable the firm's system of quality control relating to independence to function appropriately.

AU-C 220.06 explains that engagement partners may use the assistance of other engagement team members or other personnel in the firm to assist in meeting the requirements of the standard. Additionally, the requirements that are imposed on engagement partners under AU-C 220 do not relieve other engagement team members of any of their professional responsibility.

Common Concepts for Quality Control in Attestation Engagements (AT-C 105)

AT-C 105, *Concepts Common to All Attestation Engagements*, provides general principles for firms to follow when performing an engagement under the attestation standards (SSAE No. 18). AT-C 105 is a standard that directs the firm in more than applying quality control at the engagement level. Yet, one of the three objectives of AT-C 105 states that the practitioner should implement quality control procedures at the engagement level that provide reasonable assurance that the attestation engagement complies with professional standards and applicable legal and regulatory requirements. The attestation standard places the responsibility primarily on the engagement partner to ensure that this objective is met. However, the application guidance indicates that engagement teams also have a responsibility to implement quality control procedures that are applicable to the attestation engagement. Engagement teams may rely on the firm's QC system when implementing quality control procedures unless the engagement partner conveys that it is inappropriate to do so based on information provided by the firm or other parties.

Engagement-level Quality Control under the SSARS (AR-C 60)

AR-C 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services,* provides general principles for firms to follow when performing an engagement under the SSARS. AR-C 60 is a standard that directs the firm in more than applying quality control at the engagement level. However, it does provide certain engagement-level quality control requirements and guidance that the engagement partner should follow. While there is not a requirement for every QC element included in QC 10 (unlike AU-C 220), several of the QC elements are specifically addressed in AR-C 60. The responsibility to ensure compliance with those engagement-level quality control requirements is primarily placed on the engagement partner. However, the related application guidance indicates that the engagement team also has responsibility to implement engagement-level quality control procedures. In meeting the requirements, the engagement team may rely on the firm's quality control system unless the firm or other parties have indicated that it is inappropriate to do so. The engagement-level QC requirements of AR-C 60 are discussed later in this course.

SELF-STUDY QUIZ

Determine the best answer for each question below. Then check your answers against the correct answers in the following section.

1. A firm's quality control (QC) system should do which of the following?

   a. Ensure that the firm issues reports for its engagements.

   b. Ensure personnel comply with professional standards.

   c. Provide the firm absolute assurance on various topics.

   d. Eliminate the need for policies and procedures.

2. An unconditional professional requirement is indicated by use of which of the following words?

   a. Should.

   b. Might.

   c. Could.

   d. Must.

3. Ensuring that a firm has enough competent and capable personnel to perform its engagements is part of which element of quality control?

   a. Leadership responsibilities.

   b. Acceptance and continuance.

   c. Human resources.

   d. Engagement performance.

SELF-STUDY ANSWERS

This section provides the correct answers to the self-study quiz. If you answered a question incorrectly, reread the appropriate material. **(References are in parentheses.)**

1. A firm's quality control (QC) system should do which of the following? **(Page 4)**

   a. Ensure that the firm issues reports for its engagements. [This answer is incorrect. According to QC 10, one purpose for a firm's QC system is to ensure that reports issued by the firm are appropriate in the circumstances.]

   b. Ensure personnel comply with professional standards. [This answer is correct. Per the guidance provided by QC 10, one purpose of a firm's QC system is to ensure that the firm and its personnel are complying with professional standards and applicable legal and regulatory requirements.]

   c. Provide the firm absolute assurance on various topics. [This answer is incorrect. According to QC 10, the firm's QC system will provide the firm reasonable assurance on certain issues, not absolute assurance.]

   d. Eliminate the need for policies and procedures. [This answer is incorrect. In developing and maintaining a QC system, a firm should establish policies designed to achieve the objectives associated with obtaining reasonable assurance and procedures to implement and monitor compliance with those policies.]

2. An unconditional professional requirement is indicated by use of which of the following words? **(Page 5)**

   a. Should. [This answer is incorrect. Presumptively mandatory requirements are identified by the word *should*. These requirements can be departed from in rare instances, if justification is provided.]

   b. Might. [This answer is incorrect. The application and other explanatory material provides additional guidance on professional requirements or identifies other procedures or actions. While a firm is not required to perform the other procedures or actions, the information is relevant to the proper application of the requirements. Among others, the word *might*, can be used to describe these actions and procedures.]

   c. Could. [This answer is incorrect. Among others, the word *could* is used by additional procedures or actions provided in explanatory material.]

   d. Must. [This answer is correct. Unconditional requirements are those the firm must follow in all cases if the circumstances apply to the requirement. These requirements use the word *must*. The categories of professional requirements are established by QC 10.08.]

3. Ensuring that a firm has enough competent and capable personnel to perform its engagements is part of which element of quality control? **(Page 7)**

   a. Leadership responsibilities. [This answer is incorrect. According to SQCS No. 8, the QC element of leadership responsibilities for quality within the firm was designed to provide reasonable assurance that the firm establishes the policies and procedures to promote an internal culture that is based on the recognition that quality is essential in performing engagements.]

   b. Acceptance and continuance. [This answer is incorrect. As described in SQCS No. 8, this QC element provides reasonable assurance that the firm undertakes only client relationships and engagements in which the firm (1) considers the client's integrity and does not have information that would indicate the client lacks integrity; (2) determines the firm has the competence, capabilities, and resources to perform the engagement; and (3) determines the firm can comply with applicable legal and regulatory requirements.]

c. Human resources. [This answer is correct. SQCS No. 8 includes the QC element of human resources, which is designed to provide reasonable assurance that the firm has sufficient personnel with the competence, capabilities, and commitment to ethical principles to (1) perform engagements in accordance with professional standards and applicable legal and regulatory requirements and (2) enable the firm to issue reports that are appropriate in the circumstances.]

d. Engagement performance. [This answer is incorrect. Per SQCS No. 8, the QC element of engagement performance is designed to provide reasonable assurance that work performed by engagement personnel consistently complies with professional standards and applicable legal and regulatory requirements, and the firm issues reports that are appropriate in the circumstances.]

MAKING A COMMITMENT TO QUALITY

Improving engagement quality is the foundational concept pervasive in QC 10. In order to capture the spirit of the QC standard, the firm needs to make a serious commitment to quality. The need for commitment cannot be emphasized too strongly, and it should be viewed by firm personnel as long-term and coming from the top down. Improving and maintaining excellence within the firm demands a commitment on the part of every individual.

To make a true commitment to quality, firm management has to exhibit effective leadership; change or reinforce firm culture; and devote sufficient financial, personnel, and physical resources to the quality control effort.

Effective Leadership

Effective leadership is an essential ingredient for success in most team-oriented endeavors. A commitment to quality compels firm management to lead by example. The firm quality control system needs to be rooted in firm management's expectations of, and insistence on, quality. The firm's partners have a responsibility to ensure that a commitment to quality is clearly embedded in the firm's values and culture. Their actions need to reflect an appropriate tone at the top that engenders a commitment to quality throughout the firm. In many cases, the ultimate determination of whether the firm maintains an effective system of quality control over time is largely a function of how well the firm's leadership group supports the system.

Firm Culture

An assessment of the firm's culture is an important step in the process of developing, improving, and keeping current a firm's system of quality control. *Firm culture* can be defined in this context as the shared assumptions, beliefs, and behaviors of firm personnel. To a large extent, what we do is determined by our culture. The same individual in two different firms may act in different ways, depending on the firm's culture.

Essential elements in sustaining a quality-conscious firm culture include an unwavering belief in the importance of quality and adaptability and a cooperative attitude among partners. If those elements do not exist or exist to an insufficient degree, they need to be cultivated. In some cases, that may mean emphasizing to those who lack the appropriate attitude that the stakes are high. They may have to be reminded that failing to establish and maintain an effective system of quality control can have a crippling effect on the firm over time.

Adaptability, the willingness to change and support change, is a critical component of infusing a commitment to quality into firm culture. Adaptability may take the form of a new system of policies, procedures, and the related supporting documentation; a significant change to the existing system; or a requirement to hire additional technical personnel. In any case, the quality control effort will necessitate a willingness from firm personnel to accept those changes.

Likewise, developing, improving, and keeping the quality control system current will entail a cooperative attitude among the firm's partners. Passive resistance can sabotage the effort. If the firm's existing culture is deficient and needs to be changed or improved to instill a commitment to quality, such change or improvement may take time because cultural change is not easy. When a change in culture is needed, the effectiveness of the firm's leadership in promoting quality is critical.

Once new procedures are adopted, the message from the firm's leadership needs to be clear. The firm's commitment to quality will not be compromised, regardless of the engagement or the circumstances. No attest service can be considered too insignificant or too rushed to dispense with required QC policies and procedures.

Dedication of Time and Resources

To establish and maintain an effective quality control system, the firm needs to devote the time and resources necessary to ensure that the QC system put into place is appropriate and that it continues to be effective. It is important to recognize that there will be start-up costs associated with establishing a QC system and, unless the firm is willing to commit to those costs, the effort cannot succeed. A realistic assessment needs to be made of the total investment in terms of time, money, and personnel resources that will be necessary. That investment is ordinarily recouped in later years through improved efficiency and well-managed growth. Many firms recognize an even earlier recovery of their investment by implementing time-saving suggestions and eliminating unnecessary procedures uncovered as the quality control system is refined. In the initial stages, though, the effort to develop or improve a quality control system represents a resource commitment by the firm.

Benefits to the Firm of Establishing and Maintaining an Effective QC System

Delivering high quality services is the driver for success for most professional service firms and CPA firms are no exception. As mentioned at the beginning of this lesson, performing quality services is vital to increasing the firm's profitability, maximizing the firm's value, and potentially even guaranteeing its long-term succession plans and viability. Clearly there are sound business reasons for establishing and maintaining an effective system of quality control. The most noteworthy of those reasons are to improve the quality of the firm's accounting and auditing services and increase its efficiency in delivering those services.

Improved Quality of Work. It logically follows that an effective quality control system will yield an improved work product. Quality control measures reduce the risk of error and noncompliance with professional standards. Clearly communicated policies and procedures provide greater assurance to partners that staff members are performing appropriately and that the firm's work product is accurate and complete. In addition, improved work quality ordinarily has residual benefits, such as improved staff morale and reduced litigation risk.

Improved Staff Morale. Association with a firm that actively strives to perform only high-quality services buttresses professionalism. It enhances the self images of partners and staff, pride in the firm, and overall morale. A quality control system that is operating effectively will often have an especially beneficial effect on staff morale, and ultimately staff retention, because of the heightened emphasis placed on increasing technical proficiency, professional development, career counseling, advancement, and related matters that are important to staff.

Reduced Risk of Litigation. The risk of being involved in a lawsuit, or more importantly, the risk of having a successful suit brought against the firm, can be minimized by a QC system that reduces the potential for error and increases the quality of engagement and other required documentation.

Increased Efficiency in Delivering Services. Over time, as the quality control system is refined and administrative and operating procedures are improved, the general efficiency of the firm's quality control system operations often increases. Documentation, standardization, and consistency of operations usually have the effect of improved productivity. This is particularly important as the firm and its staff grows. It is during periods of growth that operational efficiency and structure become increasingly critical to ensuring that the firm continues performing high-quality engagements. The lack of such structure and order can cause a firm to lose its competitive edge.

AICPA 6-Point Plan to Improve Quality Initiative

Having an effective QC system has always been a vital aspect of performing effective and compliant engagements. An ongoing AICPA initiative, *Enhancing Audit Quality* (EAQ), launched in May 2014, focuses even more attention on the importance of engagement quality. The initiative aligns all AICPA audit and assurance related activities with the goal of supporting firms' quality improvement. In May 2015, the AICPA released its *6-Point Plan to Improve Audits* (6-Point Plan), which addresses specific audit quality issues and provides a roadmap to the profession for maintaining and improving audit quality. The 6-Point Plan concentrates on financial statement audits of private companies, with a focus on the specialized audits of employee benefit plans and governmental entities. The 6-Point Plan initially outlined enhancements in support of audit quality in the following areas [the information in brackets identifies some of the changes that have already taken place]:

- *Pre-licensure.* Enhancements would update the CPA exam to increase assessment of higher-order skills, add high school advance placement classes in accounting; and revise college-level accounting education. [The Uniform CPA Examination was updated effective as of April 1, 2017, and is significantly different from earlier exams due to its increased focus on critical thinking, analytical ability, problem-solving, professional skepticism, and effective communication.]

- *Standards and Ethics.* Proposed changes include quality control standards implementation support, revisions to the auditor's report, codification of the ethics requirements, and evaluation of the implementation of the clarified auditing standards. [The codification of the *Code of Professional Conduct* was completed in 2014, which, among other things, provides new online functionality. Additionally, the ASB issued an exposure draft in November 2017 that proposes changes to the auditor's report.]

- *CPA Learning and Support.* Enhancements would include competency models for audits, competency assessment tools and resources, new certificate programs, and new learning programs. [Among other things, changes already in place include new certificate programs under the auspices of the AICPA, and revised CPE standards effective as of September 1, 2016, that allow for new types of learning.]

- *Peer Review.* Enhancements would include an increased peer review focus on higher-risk industries, including employee benefit plans and single audits, and more significant remediation plans. [The AICPA Peer Review Board has already made significant reforms to the peer review process and continues to focus on that area.]

- *Practice Monitoring of the Future.* This long-term initiative focuses on real-time, ongoing monitoring of firm quality checks. [The AICPA and its Peer Review Board launched a new web-based peer review online system in May of 2017, that will adapt quicker to the needs of practice monitoring and users of that information.]

- *Enforcement.* Enforcement focuses on aggressive investigation of referrals of deficiencies and enhanced coordination with state boards of accounting. [The Peer Review Board has increased the qualifications sought of peer reviewers and sped up the process for reviewers who do not satisfy the requirements. Additionally, if firms fail to appropriately remediate, they may now be more quickly terminated from the Peer Review Program for noncooperation and the applicable state boards of accountancy are notified.]

More information about the AICPA's EAQ initiative and its 6-Point Plan is available at **www.aicpa.org/InterestAreas/PeerReview/EAQ.html**. Since 2016, the AICPA has provided an annual highlights and progress report on its EAQ initiative that also includes information on planned future steps. Those reports are available at the previously mentioned URL.

THE DEVELOPMENT AND IMPLEMENTATION OF AN EFFECTIVE QC SYSTEM

There is not just one right approach to developing and implementing a system of quality control. However, a general project management approach that may be used by the quality control director is outlined in this lesson. More specific recommendations regarding each of the individual elements of quality are beyond the scope of this course, but can be found in *PPC's Guide to Quality Control*. Taken in chronological order, firms are likely to benefit from performing the following steps:

- Set a realistic timetable for implementation.

- Accumulate and review all relevant professional literature.

- Assess the current status of the firm's QC policies and procedures and establish a plan for developing the system.

- Review the plan and timetable with the other partners.

- Develop quality control policies and procedures for all elements and relevant activities of quality control.

- Communicate the policies and procedures to firm partners and other professionals to initiate implementation of the system.

- Monitor implementation of the system and provide additional training to individuals or groups, as needed.

- Perform monitoring procedures on the system and make modifications as necessary.

Setting a Realistic Timetable for Implementation

Before the firm is ready to begin the process of establishing a QC system, a realistic timetable for completing the project needs to be established. It is important for the timetable to consider when the firm will be undergoing its first or next review. Firms that enroll in the AICPA Peer Review Program generally have only 18 months during which to implement an effective QC system and undergo their first review. Newly formed firms with AICPA members (and other firms that will have a peer review for the first time) are required to establish an appropriate quality control system as soon as practical after the firm is established. As a result, firms need to set their timetables to ensure that their quality control systems are in place within the first few months, if possible, so their QC systems are fully operational prior to the commencement of their first peer review.

This course suggests a realistic (although ambitious) timetable for implementing a quality control system within an 18-month period, which could be apportioned as follows:

- First two months—develop and implement the system.
- Next 12 months—complete one year's work (the peer review period) and monitor the QC system.
- Last four months—complete the first peer review.

It is unlikely the firm can successfully meet this ambitious timetable unless the project is given a high priority. It takes some firms significantly longer than anticipated to implement and refine their systems to a point where they are ready to undergo peer review.

Reviewing Relevant Professional Literature

The nature of the professional literature that is relevant will vary with each element of quality control and the type of services the firm provides. Ordinarily, professional literature will consist of authoritative literature (such as the AICPA's SSARS, SSAEs, and SASs and the *Code of Professional Conduct*), the requirements of various professional associations (the AICPA Audit Quality Centers, state societies of CPAs, etc.), and the requirements of various regulatory bodies (state boards of accountancy and other regulatory agencies that regulate clients' industries). (The GAO's *Government Auditing Standards* includes quality control system requirements, which should be included in a firm's QC policies and procedures.)

Assessing the Current QC System and Establishing a Plan

In this planning stage, the individual designated by the firm to be responsible for developing the QC system (usually the quality control director) obtains the information necessary to begin developing an implementation plan. Since most firms have some aspects of a quality control system already in place, the firm would ordinarily perform an analysis of the existing system first. The extent to which aspects of a system already exist will impact how much additional work needs to be done to put an effective QC system in place. Documentation of existing policies and procedures can be reviewed to determine what is still relevant. The firm can then devise an implementation plan that reflects what remains to be done and considers the resources needed.

Reviewing the Implementation Plan and Timetable with Partners

It is appropriate for the quality control director or another designated partner to present the plan and timetable to the partner group. How formal and structured such a presentation is will depend on the size and operating style of the firm. However, in considering how elaborate to make the presentation, the preparer needs to keep in mind that this is the primary communication device to elicit the support of the partner group. The presenter needs to provide whatever information is considered necessary to obtain partner cooperation and commitment to the project.

Developing the QC Policies and Procedures

The drafting of the firm's policies and procedures and related documentation should be done for each element and activity of the firm's quality control system. An in-depth discussion of this for each QC element is beyond the scope of this course, but more information (including suggested policies and procedures) can be found in *PPC's Guide to Quality Control*.

Communicating the QC Policies and Procedures to all Professionals

The nature and format of such a communication is generally a function of firm size. For firms with a sufficient number of professionals to warrant it, a seminar or formal presentation may be desirable. This step represents the introduction of the QC system to firm personnel. It is the beginning of the implementation stage. To reach this point, the following conditions ordinarily exist:

- Agreement has been reached regarding all aspects of the system.
- Access to the firm's policies and procedures is readily available to all professional staff.
- Forms, checklists, and other necessary practice aids and documentation are readily available.

When a seminar or formal presentation is conducted, the firm might desire to have the session qualify for in-house CPE credit.

Monitoring Implementation of the QC System and Providing Additional Training

Monitoring the progress of the QC system implementation is an ongoing process designed to determine that the policies and procedures put into place by the firm are appropriately designed and operating effectively. This will generally require the quality control director to:

- Actively inquire whether the partners and staff understand and adhere to new policies and procedures and use the related forms and checklists.
- Create a mechanism for staff to openly communicate any problems or issues that occur when performing engagement services. This may include forming a quality assurance committee, composed of all levels of professionals, to discuss issues that arise and propose suggestions for improvements.
- Perform periodic spot inspections/reviews of workpapers, reports, forms, and checklists to determine whether or not the system is functioning properly.

When performing the procedures described above, the quality control director will often identify areas for improvement. The quality control director then determines what changes are needed in the firm's QC policies and procedures. Once that is done, the quality control director may find it beneficial to provide training to specific individuals or groups regarding the changes to the QC policies and procedures to ensure that those involved both understand and comply with the changes.

Performing Monitoring Procedures on the System and Making Modifications

Monitoring procedures are performed to determine whether the firm's quality control policies and procedures are working properly and are being complied with in practice. Naturally, this assumes that the system has been designed, implemented, and fine-tuned. In many cases, monitoring procedures may identify situations that require remedial action. This is particularly true with regard to a newly-introduced system.

Designing, or significantly modifying, and implementing a firm's quality control system is not generally an endeavor that will be completely correct the first time. As the new, or significantly modified, QC system starts getting used by the firm, both small and not-so-small changes may need to be incorporated into the QC system before firm leadership starts to feel like they have gotten it right. Thus, firms can expect a period of continued modifications to the QC system after it is first implemented.

Obtaining External QC Consulting Assistance. For some firms, especially those whose partners specialize in tax work, the task of implementing a QC system over their accounting and auditing practice may be especially challenging. The ongoing demands of the practice or the lack of familiarity with formalized administrative and supervisory systems may make it extremely difficult to develop and implement a QC system in a timely manner. If a firm fits into this category, the firm's time, money, and effort might best be spent hiring a firm of comparable size or a consultant to assist in implementing the system. Ideally, firms hired for such assistance have already had a peer review and received a report with a rating of *pass*.

DRAFTING A FIRM'S QC POLICIES AND PROCEDURES

What is the difference between a quality control system and a quality control document? The quality control document is the *written form of the system*. It represents the documented policies and procedures and the related forms, checklists, etc., that support those policies and procedures. QC 10 requires that the firm document its policies and procedures. However, the extent to which the firm documents such procedures may vary depending on its size, structure, and nature of the practice. It seems likely that many small and medium-sized firms can comply with the requirement to document its QC policies and procedures without designing a sophisticated QC system.

The firm is required to comply with all requirements of QC 10, including considering whether other matters or circumstances exist within the firm that require it to establish additional QC policies and procedures to satisfy the objective of the quality control standard. On the other hand, it is a best practice for firms to avoid unnecessary policies and procedures, as they can create an excessive and burdensome QC system that is difficult to comply with. For example, a firm with four professional staff members might not need to adopt policies requiring a formal staff evaluation for every job of 80 hours or more. For that size firm, such a policy may be overly stringent, with no comparable contribution to the quality of the firm's practice. Instead, the firm might adopt a policy requiring oral evaluations after every engagement of 150 hours or more, with an annual formal (written) evaluation. The best practice would be for firms to achieve a balance between designing a detailed and structured QC system and a system that complies with the QC standard as simply and straightforward as possible, based on the firm's facts and circumstances.

Creating a Comprehensive Quality Control Document

Many firms, especially smaller ones, may prefer to document their quality control system in the form of an all-inclusive statement that contains the firm's policies and procedures relating to the elements and activities of quality control. This approach may also include the relevant documents (forms, checklists, etc.) for illustrative purposes; or, it may just make reference to them. If the latter approach is chosen, such documents need to be maintained and readily available and accessible to all staff. Other firms with less complex quality control systems may choose to develop basic written QC policies and procedures that are relatively simple but address all the required elements under QC 10.

Referring to Personnel and Accounting and Auditing Manuals

Some firms maintain separate personnel manuals and/or accounting and auditing manuals for their practices. These manuals generally contain a mix of policies, procedures, and documentation to cover personnel and technical matters. Firms that have such manuals may choose to create an abbreviated quality control document that makes reference to the appropriate procedures and documents within those manuals rather than to create a separate comprehensive quality control document. However, caution is needed when using abbreviated QC documents, as discussed below.

Quality Control Materials. Many other firms adopt, or adapt to their practices, accounting and auditing manuals developed by other large accounting firms or commercial publishers, referred to as *quality control materials*. For example, the PPC brand of accounting and auditing guides published by Thomson Reuters is widely used. A listing of PPC guides is available at **tax.thomsonreuters.com**.

Quality control materials (QCM) provide guidance to assist firms in performing and reporting in conformity with professional standards and may include, but are not limited to, engagement aids (including accounting and auditing manuals), checklists, questionnaires, work programs, electronic accounting and auditing tools, and similar materials designed to be used by accounting and auditing engagement teams. When designing the firm's quality control policies and procedures, the firm should indicate the QCM that are being used, or make reference to the firm's auditing or accounting manuals that contain the firm's QCM. The firm's responsibilities for evaluating the reliability and suitability of the QCM before adopting and integrating the materials into the quality control system.

A Caution about the Use of Abbreviated QC Documents. While referencing to QC procedures contained in accounting and auditing manuals can greatly reduce the time needed to document the firm's QC system, there is one dangerous drawback to this approach. Seldom does a firm follow verbatim all of the policies and procedures contained in the manuals used by the firm. More often, the firm *adapts* the manuals to its own practice by using some of the checklists, forms, and procedures and discarding others. If a firm makes a blanket reference in its QC document to its use of a separate manual containing QCM, the firm could be held accountable during a peer review to *all the procedures* recommended by the manual unless any deviations from the QCM are documented in the firm's QC policies and procedures. Therefore, if the firm does not plan to follow all the procedures in its manuals, it needs to design some type of *bridging document* between its QC documents and the QCM to explain which procedures in the QCM are used.

Considering the AICPA Quality Control Practice Aid

In conjunction with its *Enhancing Audit Quality Initiative*, the AICPA recently developed and released e-versions of its previously published Practice Aid, *Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice* (the AICPA Practice Aid). The information is currently available at no charge on the AICPA's website at **www.aicpa.org/InterestAreas/frc/enhancingauditqualitypracticeaid.html**. The re-developed AICPA Practice Aid provides illustrative examples of various types of policies and procedures a firm may consider when developing its system of quality control under the guidelines of QC 10. Illustrative examples of quality control documents are provided for two hypothetical firms—

- Small and medium-sized firms.
- Sole practitioners.

The re-developed AICPA Practice Aid is the joint effort of the Peer Review Board and the ASB, and while not authoritative, it may be a beneficial resource for use by firms when drafting QC system policies and procedures. The revised AICPA Practice Aid includes tips, warnings, and reminders to help firms implement their QC policies and procedures.

MAINTAINING A FIRM'S QC SYSTEM

It is apparent that there are many tasks to be performed during the year that are essential to maintaining the QC system. Regardless of how quality-conscious firm management and staff are, important procedures may not be performed because someone simply forgets to perform them.

To guard against the possibility of forgetting to perform a critical administrative procedure required by the QC system, it is a best practice for firms to (a) identify the administrative tasks required by the system, (b) assign responsibility for performing the tasks, and (c) schedule the tasks on a critical date calendar. Administrative tasks required by the system normally can be identified by reviewing the QC document. However, determining timing and frequency of such tasks requires a consideration of factors including (a) peak workloads (ideally, QC tasks are best performed during nonpeak periods); (b) lead time needed for feedback (for example, a firm generally desires to review CPE files in advance of its State Board deadlines so deficiencies can be identified and corrected); and (c) coordination with other administrative procedures.

QC Maintenance Calendar

One method that firms can use to ensure that they do not forget to perform important administrative procedures is to create a calendar for maintaining the firm's QC policies and procedures for each element of quality control. Such a maintenance calendar should be suitable for the firm's unique QC system.

SELF-STUDY QUIZ

Determine the best answer for each question below. Then check your answers against the correct answers in the following section.

4. Which of the following CPA firms is demonstrating a commitment to quality?

   a. The partners at the firm of Allen & Scott like to do things the way they have always been done.

   b. The partners at Bryant & Hill establish their QC system based on what policies and procedures will be least expensive and take less time.

   c. The managing partner at Crabtree & Jones allows staff to skip QC procedures if time is tight on an engagement.

   d. The managing partner of Dew & Marion focuses on infusing a belief in the importance of quality into the firm's culture.

5. Actively inquiring whether partners and staff both understand and follow new QC policies and procedures is an example of which of the following?

   a. Monitoring.

   b. External consulting.

   c. Communicating to professionals.

   d. Assessing the current system.

SELF-STUDY ANSWERS

This section provides the correct answers to the self-study quiz. If you answered a question incorrectly, reread the appropriate material. **(References are in parentheses.)**

4. Which of the following CPA firms is demonstrating a commitment to quality? **(Page 14)**

   a. The partners at the firm of Allen & Scott like to do things the way they have always been done. [This answer is incorrect. *Adaptability*, the willingness to change and support change, is a critical component of infusing a commitment to quality into firm culture. Adaptability may take the form of a new system of policies, procedures, and related documentation, among other things. If the partners at this firm are not willing to accept change, they will not be effective at committing to quality.]

   b. The partners at Bryant & Hill establish their QC system based on what policies and procedures will be least expensive and take less time. [This answer is incorrect. To establish and maintain an effective QC system, the firm needs to devote the time and resources necessary to ensure that the QC system put into place is adequate and that it continues to be effective. It is important to recognize that there will be start-up costs associated with establishing a QC system and, unless the firm is willing to commit to those costs, the effort cannot succeed. Therefore, to demonstrate a commitment to quality, the partners at this firm need to base their decisions on quality of work rather than expense and time.]

   c. The managing partner at Crabtree & Jones allows staff to skip QC procedures if time is tight on an engagement. [This answer is incorrect. Once new procedures are adopted, the message from the firm's leadership needs to be clear. The firm's commitment to quality will not be compromised, regardless of the engagement or the circumstances. No attest service can be considered too insignificant or too rushed to dispense with required QC policies and procedures. Therefore, by allowing this, the managing partner of this firm is not exhibiting a commitment to quality.]

   d. The managing partner of Dew & Marion focuses on infusing a belief in the importance of quality into the firm's culture. [This answer is correct. *Firm culture* can be defined in this context as the shared assumptions, beliefs, and behaviors of firm personnel. Essential elements in sustaining a quality-conscious firm culture include an unwavering belief in the importance of quality and adaptability and a cooperative attitude among partners. By infusing this belief in quality into his firm, the managing partner is demonstrating a commitment to quality.]

5. Actively inquiring whether partners and staff both understand and follow new QC policies and procedures is an example of which of the following? **(Page 18)**

   a. Monitoring. [This answer is correct. Monitoring the progress of the QC system implementation is an ongoing process designed to determine that the policies and procedures put into place by the firm are appropriately designed and operating effectively. The quality control director will need to do several specific things, including actively inquiring whether partners and staff understand and adhere to new policies and procedures and use the related forms and checklists.]

   b. External consulting. [This answer is incorrect. For some firms, especially those whose partners specialize in tax work, the task of implementing a QC system over their accounting and auditing practice may be especially challenging. If a firm fits into this category, the firm's time, money, and effort might best be spent hiring a firm of comparable size or a consultant to assist in implementing the system. However, the inquiries described above are not necessarily part of external consulting, so there is a better answer choice for this question.]

c. Communicating to professionals. [This answer is incorrect. Firms need to communicate the QC policies and procedures to all professionals. The nature and format of such a communication is generally a function of firm size. However, the inquiries described above would take place after this type of communication has been made, so there is a more appropriate answer choice for this question.]

d. Assessing the current system. [This answer is incorrect. In the planning stage, the individual designated by the firm to be responsible for developing the QC system obtains information necessary to begin developing an implementation plan. The extent to which aspects of a QC system already exist will impact how much additional work needs to be done to put an effective QC system in place. However, this is one of the first steps of the process of implementing a QC system. The inquiries described above cannot be made until the new QC system is already in place; therefore, this answer does not apply.]

Lesson 2: The Peer Review Process and Undergoing a System Review

INTRODUCTION

Firms should design and implement a quality control (QC) system that will meet the requirements of applicable QC standards. The QC system should be tailored to fit each firm's unique operations. Because a firm's system of quality control (and whether it is adhered to) affects a firm's peer review, it is important to understand the peer review process, including the authoritative body, the governing standards, the types of reviews and how they are conducted, and finally, how peer reviewers report their findings. This lesson provides general guidance on the peer review process, followed by guidance on a specific type of peer review: the system review. Firms that generally undergo an engagement review may find that use of *PPC's Guide to Quality Control—Compilation and Review* is more relevant to their needs than either this course or *PPC's Guide to Quality Control*.

This lesson presents guidance on the system review process—preparing for a peer review, undergoing the review, and how the results of the review are reported. *It is, however, only a summary of the more important aspects of peer review. It is not a peer review manual; thus, it is a best practice for firms to thoroughly review the complete Peer Review Standards, Interpretations, and sections of the AICPA Peer Review Program Manual that are available to firms.*

Learning Objectives:

Completion of this lesson will enable you to:

- Identify the evolution of the peer review process over time, the benefits of undergoing peer review, and the elements of the AICPA Peer Review Program.
- Identify the planning activities that are necessary prior to a system review.
- Recognize what to expect during a system review.
- Identify the post-fieldwork activities that occur during a system review, how the review is accepted, how disagreements are resolved, and the applicable documentation and retention requirements.

Professional Guidance about Peer Reviews

The AICPA PRPM includes the current *Standards for Performing and Reporting on Peer Reviews, Peer Review Standards Interpretations,* and the policies, procedures, checklists, and programs developed by the AICPA Peer Review Board for administering and performing AICPA peer reviews. Access to the full PRPM is available only through the AICPA enhanced online professional library, which can be purchased from the AICPA Order Department at (888) 777-7077 or the AICPA's website at **www.aicpastore.com**. Additionally, access to the full AICPA Peer Review Program Manual is available for purchase on Checkpoint at **tax.thomsonreuters.com.** Limited sections of the PRPM continue to be available to the public on the AICPA's website.

The *Standards for Performing and Reporting on Peer Reviews* (Peer Review Standards) and Interpretations indicate that they were effective for peer reviews commencing on or after January 1, 2009. However, the Peer Review Standards and Interpretations are modified by the AICPA Peer Review Board as necessary, and in recent years, the Peer Review Standards (PR 100) and Interpretations (PR 9100), as well as various sections of the PRPM, have generally been updated and released at least annually. The peer review information in this course reflects the most current version of the Peer Review Standards and Interpretations released by the AICPA as of the time this course went to press, which is the December 2017 version. The information is generally effective for peer reviews commencing on or after January 1, 2018.

The PRPM provides a wealth of information about the AICPA Peer Review Program, some of which is specifically directed to the firm (as opposed to peer reviewers). The AICPA also periodically updates a document entitled *Questions and Answers about the AICPA Peer Review Program* (available from the AICPA's website at **www.aicpa.org/InterestAreas/PeerReview/Resources/FAQs/DownloadableDocuments/qandaprp.pdf**). This document provides information on commonly asked questions and answers about the AICPA Peer Review Program. The document is updated by the AICPA Peer Review Board as needed.

The Peer Review Board (PR Board) regularly issues Reviewer Alerts to communicate or clarify information regarding the Peer Review Standards, interpretative guidance, and the peer review program to assist peer reviewers in staying up-to-date with changes in the program. This course includes consideration of such information through the January 2018 Reviewer Alert. Individual Reviewer Alerts are archived on the AICPA's website at **www.aicpa.org/InterestAreas/PeerReview/NewsandPublications.html**.

In November 2016, the PR Board issued a "Reviewed Firm Alert" specifically for firms to learn more about the then recent decisions made by the PR Board; guidance changes effective January 1, 2017; and additional information. Much of that information is incorporated into the discussions in the lesson. The full "Reviewed Firm Alert" may also be accessed from the AICPA's website at **www.aicpa.org/InterestAreas/PeerReview/Community/CPAFirms/DownloadableDocuments/RevFirmAlert-GuidChanges.pdf**.

Major Peer Review Changes Effective January 1, 2017. In conjunction with the AICPA's Enhancing Audit Quality Initiative (see the discussion later in this lesson), the Peer Review Board continues to make significant changes to the AICPA Peer Review Program. For reviews commencing on or after January 1, 2017, the following changes are effective:

- Sections 4300 and 4400 (the QC Policies & Procedures Questionnaires) have been removed from the Peer Review Program Manual.

- The peer reviewer completes a separate QC system design form (during planning the review) and a QC system compliance form (during fieldwork testing of the firm's QC system).

- The peer reviewer tests compliance with each element of the firm's system of quality control.

- The peer reviewer may inquire about and review evidence from a period prior to the year under review to support assessment of the design and compliance with the QC system.

- The firm assists the peer reviewer in determining the systemic causes (the underlying reasons) for matters, findings, deficiencies, and significant deficiencies that are identified during the review.

- A separate closing meeting is held near the end of fieldwork to further discuss the reviewer's identification of issues and the anticipated review report; and the firm's responsibilities, including actions taken or planned by the firm to remediate any nonconforming engagements and any findings or deficiencies noted, and the timing of the remediation.

- Alternatively, the closing meeting and the exit conference can be combined. When appropriate, the exit conference now may occur after fieldwork and be held via teleconference.

- The Peer Review Reports now include clarified headings and provide greater transparency on the results of the review.

- The Firm Representation Letter includes new representations, and the firm may not remove required representations from their representation letter.

Other Significant Peer Review Changes

The AICPA Peer Review Board continued to revise the Peer Review Program in 2017 and 2018. As of the date of this material, the following changes have also been implemented and are in effect, unless noted otherwise:

- Firms without AICPA members are allowed to enroll in the AICPA Peer Review Program.

- The PRIMA online peer review system replaced the prior system (PRISM), requiring electronic submission of firm information and other peer review related data.

- Reasons for a firm being deemed as failing to cooperate during peer review have been expanded and clarified.

- Firms can now be dropped from the AICPA Peer Review Program for failing to annually provide timely and accurate information about their A&A practices (effective as of the year following a firm's peer review year ending after May 1, 2018).
- The "Top 3" engagement selection requirement to determine must-cover concentrations in a system review is eliminated effective May 1, 2018. (This requirement was applicable when firms did not have any practice areas or industries that comprised 10% or more of total A&A hours.)
- Noncarrying broker-dealers have been added to the list of must-select engagements.

HOW THE PEER REVIEW PROCESS HAS EVOLVED

In the 1970s, a combination of factors intensified external pressures on the profession to improve the quality of its services and to reverse the perception of substandard work. A poor economy, resulting in several highly publicized bankruptcies that developed into lawsuits against CPA firms, heightened the scrutiny of CPAs and their practices. Large liability settlements, primarily by national firms, received expanded media attention. With increased interest by Congress, it appeared that unless the profession acted quickly, the concept of self-regulation might be lost through an expansion of the SEC's powers or other federal or state agencies.

In response to these pressures, the AICPA's Council created the Division for CPA Firms in 1977. Any firm could voluntarily join one or both of its two sections—the Private Companies Practice Section (PCPS) and the SEC Practice Section (SECPS). Both the PCPS and SECPS sections required that once every three years firms were to have a peer review of their accounting and auditing practices to monitor adherence to professional standards, and that the peer review results be made available in a public file. In establishing the Division for CPA Firms, the AICPA clearly tried to strengthen the public's confidence in the profession; to alleviate pressure that might lead to government regulation; and, at the same time, to foster the quality of the member firms' accounting and auditing work.

AICPA Quality Review Program

In the 1980s, essentially the same pressures that led to the formation of the Division for CPA Firms forced the profession to once again focus on the issues of quality control and substandard work. The result was the approval in 1988 of the AICPA's *Plan to Establish a Quality Review Program and to Implement a Practice Monitoring Membership Requirement*. The plan, as amended, requires all AICPA members engaged in public practice as a proprietor, partner, or shareholder, or as an employee who has been licensed as a CPA for more than two years, to be practicing in a firm enrolled in an AICPA-approved practice monitoring program if the services performed by the firm are within the scope of the practice monitoring standards and the firm issues reports purporting to be in accordance with the AICPA professional standards. (Certain individual CPAs are required to be in a practice monitoring program.)

To administer the quality review program, the AICPA Board of Directors established the Quality Review Division and the Quality Review Executive Committee. The activities of this committee and the Quality Review Division staff have primarily focused on ensuring that all AICPA members are enrolled in an approved practice monitoring program, coordinating the efforts of the state CPA societies that have chosen to participate in the administration of quality reviews, and issuing the *Standards for Performing and Reporting on Quality Reviews*. In 1990, as the final element of the AICPA's *Plan to Restructure Professional Standards*, the AICPA membership approved a bylaw change [Section 2.3.5 of the AICPA's bylaws (BL 230R.08)] requiring firms that performed audits of SEC clients to join the SECPS. (As discussed later in this lesson, the AICPA subsequently replaced the SECPS. BL 230R.08 was deleted in November 2007.)

AICPA Peer Review Program

In 1994, the AICPA quality review program and the PCPS peer review program were combined. The combined program is the present AICPA peer review program. The term *quality review* was replaced by the term *peer review*, which is used throughout this course.

Beginning in 2000, a poor economy and a number of frauds, accounting scandals, and bankruptcies again heightened the scrutiny of CPAs and their practices to recur. The highly publicized collapses of Enron and WorldCom resulted in the following:

- Lawsuits against Enron's and WorldCom's auditors.
- Questions about the quality and independence of auditors in particular and the accounting profession in general.
- Congressional investigations.
- Calls for tighter accounting and auditing standards and a more independent review mechanism for firms with SEC audit clients.
- The passage of the Sarbanes-Oxley Act of 2002, which created the Public Company Accounting Oversight Board to provide stricter standards and a more independent quality review mechanism for firms that perform audits of public companies.

Although the focus of attention was on auditors of public companies, cascading effects from Sarbanes-Oxley also affected auditors of nonpublic companies. For example, in the wake of Sarbanes-Oxley, which requires that the workpapers for public company audit clients be maintained for seven years, some states have adopted seven-year retention periods applicable to both public and nonpublic company audits. Additionally, AU-C 230, *Audit Documentation*, specifically indicates that audit workpapers should be retained for a period not shorter than five years from the report release date.

Public Company Accounting Oversight Board

The Sarbanes-Oxley Act of 2002 (the Act) created the Public Company Accounting Oversight Board (PCAOB) to provide standards and a more independent quality review mechanism for audit firms with public company clients. The PCAOB has the authority to establish audit, attestation, quality control, ethics, independence, and other standards relating to audits; conduct inspections of accounting firms that have public company clients; and impose sanctions for violations of its standards and rules. (Accounting standards continue to be set by the FASB.) Firms that conduct public company audits must register with the PCAOB.

With the PCAOB conducting inspections of registered firms' public company practices, the role of the AICPA's SECPS with respect to such reviews was no longer required. However, the PCAOB's jurisdiction relates only to a registered firm's SEC practice, not to its entire practice. Thus, PCAOB inspections do not satisfy AICPA membership requirements or state licensing requirements that call for peer reviews of a firm's entire accounting and auditing practice. Neither do PCAOB inspections satisfy quality review requirements of other regulatory agencies such as the GAO and FDIC.

Evolution of Non-SEC Accounting and Auditing Practice Peer Review for PCAOB Registered Firms

In 2003, to respond to the peer review needs of firms that provide both SEC and non-SEC audit services, the AICPA replaced the SECPS with the Center for Public Company Audit Firms (CPCAF). The purpose of the CPCAF was to administer a peer review program as a bridge between PCAOB inspections and state licensing and other federal regulatory practice review requirements by focusing on the non-SEC accounting and auditing services of firms registered with the PCAOB. In addition to providing a peer review program, the CPCAF developed technical and educational guidance for its members and commented on technical and regulatory matters on its members' behalf.

In 2007, the AICPA announced the restructuring and expansion of the former CPCAF by launching the Center for Audit Quality (CAQ), a separate autonomous nonprofit organization affiliated with the AICPA. The mission of the CAQ is to foster confidence in the audit process and to aid investors and the capital markets by advancing constructive suggestions for change rooted in the profession's core values of integrity, honesty, and trust. Member firms receive communication of regulatory development, best practices guidance and technical updates, and access to a forum to express their views on matters that impact public company audits. Detailed information about the CAQ is available from its website at **http://thecaq.org**. The CAQ is not involved with providing any form of peer review program. The peer review responsibilities of the CPCAF have been assumed by the National Peer Review Committee of the AICPA.

As the previous discussion conveys, the present day AICPA Peer Review Program has transitioned over the past 40 plus years. The current AICPA Peer Review Program is a combination of the Quality Review Program and the PCPS peer review program, plus elements of the non-SEC related CPCAF peer review program.

Nonpublic Broker-dealers. In 2010, the PCAOB began a proposal for an interim broker-dealer inspection program to inspect broker-dealers representing all types of broker-dealers (including nonpublic broker-dealers). Subsequent annual progress reports on the PCAOB interim inspection program issued in August of 2012–2017 have all indicated significant audit deficiencies.

Final SEC Broker-dealer Rules. In July 31, 2013, the SEC finalized its broker-dealer rules requiring audits of all broker-dealers (including nonpublic broker-dealers) to be performed under PCAOB standards. The finalized rules also require a new Compliance Report examination for carrying broker-dealers and an Exemption Report review for noncarrying broker-dealers, both to be performed using PCAOB standards. The rules were effective for fiscal years ending on or after June 1, 2014.

The PCAOB has continued its interim inspection program, which has now extended into 2018. The PCAOB indicates that it intends to issue a proposal for a permanent inspection program that will finally determine whether or not to exempt any category of registered firms (e.g., firms that audit noncarrying nonpublic broker-dealers) from the program. Until the PCAOB permanent inspection program is announced, audits of nonpublic broker-dealers are being included in the scope of the AICPA peer review program, even though firms are now performing such engagements under PCAOB standards. Those nonpublic broker-dealer audit firms are also required to have their peer review administered by the National PRC.

Other Audit Quality Centers

Governmental Audit Quality Center. *Government Auditing Standards* (Yellow Book) require that a CPA firm conducting audits under the Yellow Book have an external quality control review at least once every three years. This requirement must be met within three years after starting a firm's first Yellow Book audit. The Yellow Book requires audit firms to make their peer review reports publicly available. In addition, the Yellow Book stipulates quality control policy and procedure requirements, including a requirement for a firm to prepare documentation that demonstrates compliance with its quality control system. The AICPA has the Governmental Audit Quality Center (GAQC), a web-based group for CPA firms that perform Yellow Book audits. The GAQC provides members a means of finding training, guidelines, and other resources for improving audit quality.

Membership in the GAQC is voluntary, but the following membership requirements apply:

- At admission, the firm must designate an audit partner to have firmwide responsibility for the quality of the firm's Yellow Book audit practice. That partner must meet the Yellow Book's CPE requirements, even if that partner would not otherwise be subject to those CPE requirements. That partner must also participate in an annual Center-sponsored webcast on recent developments in governmental auditing.
- At admission, all U.S. audit partners who are eligible for AICPA membership must be AICPA members.
- Within six months of admission to the GAQC, establish, document, and communicate quality control policies and procedures specific to the firm's governmental audit practice that comply with applicable professional standards and GAQC membership requirements. Complying with applicable professional standards includes meeting certain continuing professional education requirements of those standards, such as those required by the GAO.
- Within three months of admission to the GAQC, establish annual internal inspection procedures that include a review of the firm's governmental audit practice and compliance with the GAQC's membership requirements. This inspection is in addition to the monitoring requirement of the QC 10. Results of the annual internal inspections should be made available to the firm's peer reviewer. The firm's monitoring process should include review of the firm's compliance with the GAQC's membership requirements.

- At admission, make publicly available information about the most recently accepted peer review.
- Have a peer review team member who is employed by a GAQC member firm perform the review of governmental audits selected for review.
- Periodically file with the GAQC information about the firm and its governmental audit practice and allow such information to be available for public inspection.
- Pay dues and comply with additional requirements as may be established by the GAQC's Executive Committee and approved by the AICPA's Board of Directors.

More information about the AICPA's Governmental Audit Quality Center and its benefits and membership requirements appears at **www.aicpa.org/InterestAreas/GovernmentalAuditQuality.html**.

Employee Benefit Plan Audit Quality Center. The AICPA also has an Employee Benefit Plan Audit Quality Center (EBPAQC). Its benefits are similar to those of the Governmental Audit Quality Center discussed above. Membership in the EBPAQC is voluntary. The membership requirements include the following:

- At admission, the firm must designate an audit partner to have firmwide responsibility for the quality of the ERISA employee benefit plan audit practice. That partner must participate in an annual Center-sponsored Designated Partner planning webinar on recent developments in employee benefit plan auditing each year.
- At admission, all U.S. audit partners that are eligible for AICPA membership must be AICPA members.
- The firm must establish a program for ensuring that all ERISA employee benefit plan engagement personnel have adequate knowledge, through on-the-job training and CPE, of professional standards, rules, and regulations relevant to ERISA audits.
- Establish quality control policies and procedures specific to the firm's employee benefit plan audit practice that comply with applicable professional standards and EBPAQC membership requirements. Those policies and procedures must be documented and appropriately communicated.
- Establish annual internal inspection procedures that include a review of the firm's ERISA employee benefit plan audit practice and compliance with the EBPAQC's membership requirements. This inspection should be performed by an experienced person knowledgeable of current accounting and auditing practices relevant to ERISA employee benefit plan audits. This is in addition to the monitoring requirement of QC 10. Results of the annual internal inspections should be made available to the firm's peer reviewer.
- At admission, make publicly available information about the most recently accepted peer review.
- Have a peer review team member who is employed by a EBPAQC member firm perform the review of ERISA employee benefit plan audits selected for review.
- Periodically file with the EBPAQC information about the firm and its ERISA employee benefit plan audit practice and allow such information to be available for public inspection.
- Pay dues and comply with additional requirements as may be established by the EBPAQC's Executive Committee and approved by the AICPA's Board of Directors.

More information about the Employee Benefit Plan Audit Quality Center and its benefits and membership requirements appears at **www.aicpa.org/InterestAreas/EmployeeBenefitPlanAuditQuality.html**.

Transparency

As previously mentioned, members of the Governmental Audit Quality Center, Employee Benefit Plan Audit Quality Center, and the PCPS, must make information about their peer review publicly available. In general, such *transparency* requirements mean that the peer review report, letter of comments (if any), and the firm's response (if any), are placed in a public file that is accessible from the AICPA's website (**https://www.aicpa.org/forthepublic/peerreviewpublicfile.html**).

Peer Review Facilitated State Board Access. The AICPA Facilitated State Board Access program further supports user demands for greater transparency. The intent of the program is to create a nationally uniform system through which CPA firms can satisfy state board or licensing body peer review information submission requirements, increase transparency, and retain control over their peer review results. The AICPA and CPA state societies are working together to allow the process to become the primary means by which all State Boards of Accountancy obtain peer review results. Over time, this process is expected to help make submission of the firm's peer review information easier. Depending on a specific state's requirements, laws, and regulations, firms may have the option to opt out of the process, and their peer review results may or may not be made available to the firm's state board of accountancy. Additional information is available on the AICPA's website at **www.aicpa.org/InterestAreas/PeerReview/Resources/TransparencyFSBA.html**. Firms may contact their administering entity for more information regarding participation in Facilitated State Board Access.

Further Information on Transparency. The AICPA's peer review transparency webpage at **www.aicpa.org/InterestAreas/PeerReview/Resources/Transparency.html** also provides information regarding the Peer Review Task Force's recommendations and access to the PR Board's Annual Reports on Oversight and the Administering Entity Oversight Visit reports.

Enhancing Audit Quality and the Future of Practice Monitoring Initiative

The AICPA launched an initiative known as, "Enhancing Audit Quality" in May 2014. The Enhancing Audit Quality (EAQ) initiative has been aligning AICPA audit-and assurance-related activities to improve the quality of audits of private entities. The first phase of the initiative involved short-term efforts to be completed quickly to improve quality. The second phase of the EAQ includes long-term plans that, among other things, have been transforming the Peer Review Program through a combination of technology and human oversight in practice monitoring.

In December 2014, the AICPA released the *Future of Practice Monitoring Concept* paper. The paper describes a concept designed to include both internal and external monitoring of firm activities, encompassing all accounting, auditing, and attestation engagements firms perform for private entities. The PR Board began taking significant EAQ-related steps in 2015 to, among other things, improve the quality of reviewers. Various changes, which primarily include more rigorous reviewer qualification requirements (particularly for reviewers of certain specialized industry engagements) and removing deficient reviewers more expeditiously, went into effect for reviews as of December 31, 2015. The PR Board has continued to focus on the quality of reviewers by implementing further changes in 2016 and 2017.

Also in 2015, the Peer Review Oversight Committee, began a process of enhanced oversight designed to determine the appropriateness of peer review report conclusions. The enhanced oversight process continues and the PR Board has periodically revised the process to achieve more impact. For example, the PR Board is moving forward on promptly evaluating a firm's engagement performance in a "new" industry, rather than waiting for the firm's next peer review.

The PR Board has also taken steps to terminate a firm's enrollment in the AICPA Peer Review Program when a firm fails to properly report all of the engagements they perform. Additionally, firms that do not appropriately improve performance after initially receiving a peer review report of *pass with deficiencies* or *fail* could be subject to noncooperating remedies, including quicker termination from the program. These changes are discussed further later in this lesson.

The AICPA envisions the EAQ initiative to be a multi-year project. Access to the EAQ paper, the *Future of Practice Monitoring Concept*; a recently released *Enhancing Audit Quality; 2017 Highlights and Progress* report, previous annual EAQ highlights and progress reports, and additional information about the project is available at **www.aicpa.org/InterestAreas/PeerReview/EAQ.html**.

Other Practice Monitoring Initiatives

In addition to the AICPA's national programs for practice monitoring, all 50 state boards of accountancy now require mandatory peer review for licensure or license renewal. (Delaware was the last of the 50 states to require practice monitoring, effective as of July 1, 2017.) Other governmental regulations, such as those implementing the FDIC Improvement Act of 1991, also require auditors to participate in a practice monitoring program.

THE BENEFITS OF UNDERGOING PEER REVIEW

Benefits of Peer Review to the Firm

As previously discussed, firms with an accounting and auditing practice are required to comply with QC 10, which includes periodic peer review of a firm's system of quality control (system review) or periodic review of a firm's engagements (engagement review). Additionally, all state boards of accountancy require its licensees to undergo peer review, and other regulators require peer review in order to perform engagements and to issue reports under their standards. Although peer reviews are a mandatory component of operating a public accounting practice, when firms undergo peer review a number of benefits to the firm may be derived. Benefits include:

- The opportunity to discuss the firm's issues and partners' concerns with an interested and knowledgeable peer reviewer. Most peer reviewers are happy to share their experiences to assist the reviewed firm in addressing its issues, identifying engagement efficiencies, and avoiding potential pitfalls the peer reviewer identifies.

- Positive effect on the firm's self-perception and staff morale. A successfully completed peer review validates that the firm has attained a level of quality deemed appropriate by its profession.

- The use of a successfully completed peer review in its marketing program. Firms may prominently mention on their website, in business proposals, through a press release, etc., the successful completion of their peer review. Additionally, firms may describe the peer review process, benefits, and significance of passing peer review.

- Turning a negative situation around. Firms that experience a less than successful result on peer review can correct the identified deficiencies and then know that their system of quality control is operating effectively. The firm may request its next peer review before the regularly scheduled time of three years, receive a peer review rating of *pass*, and then enjoy the benefits of having completed a peer review successfully.

- The detection of quality control issues through peer review allows firms the opportunity to make changes before significant deficiencies result in litigation.

Benefits of Peer Review to Third Parties

Third parties also benefit from the peer review process. Benefits include:

- Serving the public interest by promoting quality in the accounting and auditing services provided by CPA firms subject to the Peer Review Standards.

- Helping to provide accurate and complete financial information to the firm's clients since the firm is regularly undergoing scrutiny of its accounting and auditing practice.

- Permitting potential clients to compare CPA firms that are proposing to perform audit or accounting services. [The AICPA provides access to a firm's most recently completed peer review (if the firm is a member of the AICPA's Center for Audit Quality, Governmental Audit Quality Center, Employee Benefit Plan Audit Quality Center, or Private Companies Practice Section) through its searchable public file database.

FULFILLING THE REQUIREMENTS OF THE AICPA PEER REVIEW PROGRAM

If a CPA firm has an accounting and auditing practice as defined by the Peer Review Standards, the firm should enroll in the AICPA Peer Review Program or the peer review program of the National Peer Review Committee (National PRC). If the firm does not perform accounting and auditing services as defined by the Peer Review Standards, the firm is not required to undergo peer review. Individual CPAs in non-CPA owned firms must enroll in a peer review program if they perform SSARS compilations and issue compilation reports.

Until recently, in order for a firm to enroll in the AICPA Peer Review Program, at least one of the firm's partners had to be a member of the AICPA and the ownership of the firm had to be in compliance with Council resolutions as outlined at ET Appendix B. However, the traditional requirement for a partner to be a member of the AICPA has recently changed. It is important to understand that enrollment in the AICPA Peer Review Program is required before a firm may schedule its initial peer review, as further explained later in this lesson. Enrollment in the AICPA Peer Review Program is accomplished by completing an enrollment form online through the AICPA's PRIMA system.

The AICPA *Code of Professional Conduct* requires members to practice in firms that have quality control procedures for ensuring that services are competently delivered. The bylaws of the AICPA include a requirement at BL 2.2.3 and BL 2.3.4 that persons engaged in public practice (the practice of public accounting) as an owner or as an employee who has been licensed as a CPA for more than two years, either are:

a. practicing in a CPA firm that is enrolled in an AICPA-approved practice monitoring program if the firm performs services that are within the scope of the AICPA's practice monitoring standards and the firm issues reports purporting to be in accordance with the AICPA professional standards, or

b. if authorized by Council, are themselves enrolled in such a program.

Practice monitoring programs help protect the public interest in the quality of accounting, auditing, and attestation services performed by public accounting firms. Additionally, most state boards of accountancy require licensees to undergo practice monitoring, also known as compliance assurance at the state level, to practice in their state. Other regulators, such as the GAO, require practice monitoring in order to perform engagements and to issue reports under their standards.

The term *public practice* is defined in ET 0.400.42 of the AICPA *Code of Professional Conduct* (the Code) as consisting of the performance of professional services for a client by a member or a member's firm.

AICPA Council-authorized bylaws allow individual CPAs who practice in a non-CPA owned firm (that is, an alternative practice structure) to be enrolled in a practice monitoring program. Council resolution C at ET Appendix B and BL 220R.02 allow those individual CPAs to perform SSARS compilations as long as the CPAs (a) sign their reports with their own name (rather than with the name of their non-CPA owned firm employer) and (b) undergo peer review of the compilations. Interpretation No. 3-2 of the Peer Review Standards (PR 9100.3-2) states that the term *firm* as it appears in the Standards applies to the individual CPAs practicing in a non-CPA owned firm who are enrolled in a practice monitoring program.

Objectives and Requirements

The mission of the AICPA Peer Review Board is to administer a peer review program that, as its primary objective, protects the public interest by improving the quality of accounting, auditing, and attestation services performed by AICPA members in public practice. In 2017, enrollment in the AICPA Peer Review Program was opened to CPA firms without AICPA members. Additionally, many peer reviewed firms feel that the peer review process administered by the PR Board contributes to the quality and effectiveness of their practices. To enroll in the AICPA Peer Review Program, a firm (or *individual*) must accept the following responsibilities:

- 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.

- Perform accounting and auditing engagements in accordance with applicable professional standards using competent personnel.

- Have independent peer reviews of its accounting and auditing practice.

- Engage a peer reviewer to perform the peer review in accordance with the AICPA *Standards for Performing and Reporting on Peer Reviews*, in a timely manner.

- Take appropriate measures 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 for peer reviews.

- Provide written representations to describe matters significant to the peer review.

- Understand the PR Board's guidance on resignation from the AICPA Peer Review Program.

- Cooperate with the peer reviewer, administering entity, and the PR Board in all matters related to the peer review, including anything that could affect the firm's enrollment in the program.

The term *individual*, as used in the above context, has a specific meaning and is defined in Interpretation No. 3-1 of the Peer Review Standards (PR 9100.3-1). Basically, individual AICPA members who practice only with a firm that is eligible to enroll in the program may not enroll in the program individually.

Accounting and Auditing Practice

The term *accounting and auditing practice* is defined in both QC 10 and the AICPA's *Standards for Performing and Reporting on Peer Reviews*. The Peer Review Standards (PR 100.06) indicate that an *accounting and auditing practice* consists of engagements performed under the SASs, SSARS (excluding those engagements that SSARS has provided an exemption for), SSAEs, *Government Auditing Standards* issued by the GAO, and PCAOB standards. (However, engagements subject to PCAOB permanent inspection are not included in the scope of the AICPA program.)

QC 10.13 defines an *accounting and auditing practice* as one that performs audit, attestation, compilation, review, and any other services for which standards have been promulgated by the AICPA Auditing Standards Board (ASB) or the AICPA Accounting and Review Services Committee (ARSC) under the *General Standards Rule* (ET 1.300.001) or the *Compliance With Standards Rule* (ET 1.310.001). Although standards for other engagements may be promulgated by other AICPA technical committees, engagements performed in accordance with those standards are not encompassed in the definition of an *accounting and auditing practice*. While there are subtle differences in the wording of the definitions of an accounting and auditing practice as found in the Peer Review Standards and QC 10, it is the PR Board's intent that the definitions cover the same types of engagements. Accordingly, the types of engagements subject to a firm's peer review are the same types of engagements that should be included in a firm's QC system.

Services Covered. Services included in a firm's accounting and auditing practice (as defined by the peer review and QC standards) are as follows:

- Services covered by the auditing standards (SASs) and *Government Auditing Standards*.
- Services covered by the Statements on Standards for Accounting and Review Services (SSARS):
  - Compilation engagements.
  - Review engagements.
  - Preparation engagements (as described in SSARS No. 21).
- Services covered by the attestation standards (SSAEs)
  - Reviews.
  - Agreed-upon procedures engagements, including engagements to apply agreed-upon procedures to specified elements, accounts, or items of a financial statement.
  - Examinations.
- Engagements performed under PCAOB standards that are not subject to PCAOB permanent inspection.

Are SSARS Financial Statement Preparation Engagements Subject to Peer Review? The answer to the question of whether financial statement preparation services performed under the SSARS are subject to peer review is "maybe." To further explain, the Peer Review Standards (PR 100.07) indicate that when a firm's highest level of accounting and auditing service performed is a financial statement preparation, such firms are not required to enroll in the AICPA Peer Review Program and undergo peer review. However, the Peer Review Board Interpretations go on to state that when the firm either elects to enroll in the program or is already enrolled because of the other types of engagements it performs, the firm's preparation engagements will be subject to peer review. Also, firms should be aware that state board requirements may be more stringent. Thus, while the AICPA does not require peer review of firms that perform preparation engagements as their highest level of service, practice monitoring requirements of state boards of accountancy may stipulate that firms performing SSARS engagements (which would include preparation services) must have peer reviews. In such circumstances, firms performing only preparation engagements would be subject to peer review. Accordingly, firms need to check with their state boards of accountancy.

Are Internal-use Forecast and Projection Engagements Subject to Peer Review? Some practitioners have questioned whether internal-use forecast and projection engagements are included in the definition of a firm's accounting and auditing practice as defined in the Peer Review Standards and QC 10. This course suggests that such engagements are not included in the definition and, therefore, are not required to be included in a firm's QC system. That definition relates to engagements covered by the auditing standards, SSAEs, or SSARS; internal-use engagements are not covered by any of those standards. (Internal-use forecast and projection engagements are addressed in the AICPA's *Audit and Accounting Guide—Prospective Financial Information*.) Also, most internal-use engagements are assembly engagements, in which the accountant does not provide any type of assurance. To take that suggestion further, it seems logical that such engagements would, therefore, not be subject to a firm's peer review. If it chooses, however, a firm may include such engagements in its QC system.

Types of Reviews

The Peer Review Standards provide for two types of reviews: a *system review* and an *engagement review*. Firms that perform audit engagements under the SASs or *Government Auditing Standards*, examinations under the SSAEs, or engagements under the PCAOB standards as their highest level of service are required to have a system review every three years. Firms that have an accounting and auditing practice, as defined by the Peer Review Standards, but do not perform the types of engagements that require a system review and instead perform only services under the SSARS or services under the SSAEs (excluding examinations), are required to have an engagement review every three years, but may elect to have a system review. Firms that do not perform any of the services listed in the "Services Covered" paragraph above are not required to undergo peer review. Exhibit 2-1 illustrates which type of peer review a firm is required to undergo based on its highest level of service provided. A detailed discussion of system reviews is provided later in this lesson. As previously mentioned, firms undergoing an engagement review rather than a system review may wish to consult *PPC's Guide to Quality Control—Compilation and Review*.

Exhibit 2-1

Is a System Review or an Engagement Review Required?[a]

If the *Highest* Level of Service Provided is a(n)—	System Review Required	Engagement Review Required
Audit—under the SASs, including integrated audits	X	
Audit (financial)—under *Government Auditing Standards* (*GAS*)	X	
Audit (performance)—under *GAS*	X	
Attestations (examination, review, or agreed-upon procedures)—under *GAS*	X	
Audit of non-SEC issuers—under *PCAOB Standards*	X	
Attestation of non-SEC issuers—under *PCAOB Standards*	X	
Examination—general (AT-C 205)	X	

If the *Highest* Level of Service Provided is a(n)—	System Review Required	Engagement Review Required
Examination—prospective financial information (AT-C 205 and AT-C 305)	X	
Examination—pro forma financial information (AT-C 205 and AT-C 310)	X	
Examination—compliance attestation (AT-C 205 and AT-C 315)	X	
Examination—MD&A (AT-C 205 and AT-C 395)	X	
Examination—SOC reporting (AT-C 205 and AT-C 320)	X	
Review—general attestation (AT-C 210)		X
Review—pro forma financial information (AT-C 210 and AT-C 310)		X
Review—MD&A (AT-C 210 and AT-C 395)		X
Agreed-upon procedures—general (AT-C 215)		X
Agreed-upon procedures—prospective financial information (AT-C 215 and AT-C 305)		X
Agreed-upon procedures—compliance (AT-C 215 and AT-C 315)		X
Compilation—pro forma financial information (AR-C 120)		X
Review—historical financial statements (AR-C 90)		X
Compilation with or without disclosures—historical financial statements (AR-C 80)		X
Preparation with or without disclosures—historical financial statements (AR-C 70)[b]		X

Notes:

[a] The information for this exhibit is based on Peer Review Standards Interpretation No. 7-2 (PR 9100.7-2). The exhibit has been updated for changes in SSAE No. 18, SSARS No. 22, and SAS No. 130, not yet incorporated into PR 9100.7-2.

[b] If this is the firm's highest level of engagement service, the firm may be excluded from the AICPA peer review requirement.

* * *

Timing of Reviews

The following summarized rules regarding the timing of peer reviews are applicable for firms enrolled in the AICPA Peer Review Program. Peer reviews cover a current period of one year mutually agreed on by the reviewer and reviewed firm and ordinarily are performed within three to five months after the end of the year to be reviewed. The term *due date* is used throughout the discussion in the items below. The Peer Review Standards define the term as the date by which the peer reviewer's materials, the report, and if applicable, the letter of response are to be completed and submitted to the administering entity.

a. The due date for the first peer review of a firm enrolling in the peer review program is 18 months after the firm enrolls, or should have enrolled, whichever date is earlier, except as otherwise noted below.

b. When a firm enrolled in the peer review program performs its first engagement that requires a peer review, the due date is ordinarily 18 months from the year end of the engagement that triggered the need for a review. The due date is 18 months from the report date if the engagement is a financial forecast, projection, or agreed-upon procedures engagement.

c. The due date for each subsequent peer review is three years and six months after the end of the period covered by the previous review. (Subsequent review due dates may be accelerated or delayed by the administering entity in certain situations.)

d. If, after the year end of its most recent engagement review, a firm performs an engagement that would have required the firm to have a system review, the firm should (1) immediately notify the administering entity and (2) undergo a system review. See Exhibit 2-1 for a list of engagements that require a system review. The system review is ordinarily due by the earlier of the firm's next scheduled peer review due date or 18 months from the year-end of the engagement that triggered the need for a system review (18 months from the report date if the engagement is an attestation engagement, including financial forecasts and projections). Thus, if a firm that issues its first report on an engagement that requires a system review had an engagement review in its previous peer review, the firm must undergo a system review. If the firm is scheduled for an engagement review and the report on the triggering engagement will be issued before the review due date, the firm may choose to have two reviews (an engagement review followed by the system review) or may wait until the report on the triggering engagement is issued and then undergo just a system review. As discussed in Peer Review Standards Interpretation No. 14-1 (PR 9100.14-1), firms that fail to inform the administering entity immediately when they perform an engagement that triggers requirement of a system review will be required to participate in a system review with a peer review year-end that covers the triggering engagement.

e. If a firm's most recent peer review was under the National PRC, it may defer the due date for its next review to three years and six months after the end of the previous review.

f. Firms are expected to maintain the same year-end on subsequent peer reviews (which is three years from the previous year-end). Occasionally, however, a firm may encounter a circumstance that prompts it to request a permanent change in its peer review year-end. Legitimate reasons for requesting such a change include changes in the nature of the firm's practice, for example, when engagements are performed and issued so they are available for peer review, busy season, etc. Situations such as a natural disaster or other form of destruction may also warrant a change in peer review year-end. A firm will not be granted a change in year-end if such a change would negatively impact the public interest [which may occur if the change would result in an engagement review, rather than a system review being performed, or when a change in peer review year-end would cause specific engagements (such as *must select* engagements or engagements significant for other reasons) to fall out of the peer review selection process].

g. Firms are also expected to maintain the same due date on subsequent peer reviews (which is three years from the previous due date). However, circumstances may occur that require the firm to extend its peer review due date. When such a situation occurs, the firm may only extend its peer review due date with prior, written approval of the administering entity. The extended due date only applies to the current review. (Additional information regarding due date extension requests is provided later in this lesson.)

h. The firm is responsible to ensure that any administering entity-approved change in peer review year-end or due date is also approved by any other organization that requires it to have a peer review. Typically this may include state boards of accountancy, the GAO, and other regulators.

i. If a firm resigns from the AICPA Peer Review Program and then subsequently reenrolls, the new due date is the later of the due date originally assigned to the firm or 90 days after reenrolling.

State Society Involvement

Under its peer review program, the AICPA focuses its resources on the development of standards, programs, checklists and other tools, and policies and procedures for administering the program and not on administering the reviews. Accordingly, the AICPA does not administer and approve actual reviews. Instead, state CPA societies elect, for firms whose main offices are located in that state, to do one of the following:

- Administer and approve the peer review reports (full involvement).
- Arrange for another state CPA society to administer and approve the reports.
- Ask the AICPA to find another state CPA society to administer and approve the reports.

If a state society elects full involvement, it establishes a peer review committee to be responsible for scheduling and overseeing reviews within its jurisdiction and evaluating results of reviews and requiring remedial action, if appropriate. The state society responsible for administering a state's peer review program is referred to as the *administering entity*. Most state CPA societies have elected full involvement. The reviews in the remaining states, District of Columbia, and U.S. Territories are administered by other state society administering entities.

Cost of System Reviews

Standard Reviewer Rates. Firms bear the cost of review. System reviews vary in cost depending on a number of variables including firm size, number of offices, the mix of accounting and auditing services provided, and size of the accounting and auditing practice. Additionally, a major cost variable that firms can control is the quality of the firm's work, including appropriate evaluation of the reliability and suitability of any QCM used, and the adequacy of the firm's documentation. Rates for firm-on-firm reviews and association reviews are established by the respective firms and associations.

Annual Fees. Some administering entities fund their peer review programs by charging annual fees. Others fund their programs from their current operating budgets. Of those funding from the current operating budget, some have increased the general dues and others have not. The entities charging annual fees have usually determined the fee as one of the following:

- Flat rate per firm.
- Fee that varies based on the size of the firm.
- Base fee plus an additional amount for each CPA or each professional in the firm, up to a maximum amount.

The annual fees for each administering entity can be obtained from that entity.

Administrative Fees. Administrative fees are also charged by most administering entities in the year of a review. The administrative fees for each administering entity can be obtained from that entity. Additionally, the AICPA recently began assessing an annual national peer review administrative fee for firms that undergo system review. The amount of the fee is based on the number of CPAs employed by the firm. Further information on the AICPA national peer review administrative fee is available at **www.aicpa.org/InterestAreas/PeerReview/DownloadableDocuments/FAQNPRAF.pdf**.

Cost-savings Measures. Firms that are committed to establishing, maintaining, and improving the quality of their accounting and auditing practice tend to have a more efficient peer review. It is beneficial to ensure that all personnel understand the importance of performing engagements in accordance with professional standards and properly document all required engagement procedures. When the peer reviewer identifies fewer matters because the engagement staff followed appropriate professional standards, the peer review will proceed more quickly. Additionally, when the peer reviewer can easily see what was done by reviewing appropriate documentation, the peer review will normally proceed smoothly. Having complete and accurate information available for the peer reviewer 30–40 days before the review is set to begin also helps ensure that the peer review can be completed in a timely manner and by the review due date. Other specific ideas for reducing the cost of reviews are included later in this lesson.

Peer Review for Firms Without AICPA Members

Beginning in 2017, the AICPA PR Board approved a change to the Peer Review Standards to allow firms without AICPA members to enroll in the AICPA Peer Review Program. Previously, firms without AICPA members could only enroll in a practice monitoring program administered by an appropriate state CPA society. As a result, many of the state CPA societies were administering two programs: the AICPA Peer Review Program and a separate program for firms without AICPA members. Due to the ability of firms without AICPA members to now enroll in the AICPA Peer Review Program, some administering entities have already discontinued offering their separate state program.

The AICPA believes various benefits have been, or will be, realized by having both AICPA member firms and firms without AICPA members participating in the same peer review program. Those benefits include (a) better achieving the AICPA's goal of enhancing audit quality and (b) raising the quality of firm's accounting and auditing practices for all members of the CPA profession, not just AICPA member firms.

To make the transition from a state CPA society program to the AICPA peer review program as smooth as possible, the AICPA will not require a change in the timing of the next peer review if the firm without AICPA members' most recent peer review was administered by an entity approved by the AICPA Peer Review Board. Additionally, there is no requirement for anyone in the nonmember firm to become an AICPA member in order to enroll in the AICPA Peer Review Program. Nonmember firms also join the AICPA Peer Review Program by enrolling online through the PRIMA system.

PRIMA

On May 1, 2017, the AICPA's Peer Review Integrated Management Application (PRIMA) system was launched and use of the prior online system (PRISM) was discontinued. According to the PR Board, PRIMA is more adaptable to the needs of practice monitoring and users of the system. Additionally, it integrates with other systems, such as the Facilitated State Board Assess and the AICPA's Public Files and Reviewer Search programs.

Now that the new PRIMA system is "live," firms are required to enter certain peer review information directly into PRIMA, including:

- Initially enrolling in the AICPA Peer Review Program.
- Updating firm enrollment information (such as the firm's managing partner, peer review contact, and the levels of service performed by the firm).
- Responding to Matters for Further Consideration (MFCs) during the firm's review.
- Responding to Findings for Further Consideration (FFCs) during the firm's review.

Peer reviewers also enter certain peer review related documents and handle other peer review related activities within the PRIMA system. Information on getting started with PRIMA, how to use the system, and other online training is available on the AICPA's website at **www.aicpa.org/InterestAreas/PeerReview/prima.html**.

AICPA Peer Review Program Contact Information

The AICPA Peer Review Program provides dedicated hotlines and email addresses for its two functional teams: the operations team and the technical team. Contact information for those two teams, as well as contact information for peer review senior management staff members, is available on the AICPA's website at **www.aicpa.org/InterestAreas/PeerReview.html**

Other AICPA contact information follows:

Subject	Telephone	Email	Website
PCPS	(800) 272-3476	pcps@aicpa.org	**www.aicpa.org/InterestAreas/PrivateCompaniesPracticeSection.html**
Center for Audit Quality	(202) 609-8120	info@thecaq.org	**http://thecaq.org**

Subject	Telephone	Email	Website
Employee Benefit Plan Audit Quality Center	(888) 777-7077	ebpaqc@aicpa.org	**www.aicpa.org/InterestAreas/EmployeeBenefitPlanAuditQuality.html**
Governmental Audit Quality Center	(888) 777-7077	gaqc@aicpa.org	**www.aicpa.org/InterestAreas/GovernmentalAuditQuality.html**

FAQs. The AICPA has information entitled *Questions and Answers about the AICPA Peer Review Program* that can be downloaded from the AICPA website at **www.aicpa.org/InterestAreas/PeerReview/Resources/FAQs/DownloadableDocuments/qandaprp.pdf**.

SELF-STUDY QUIZ

Determine the best answer for each question below. Then check your answers against the correct answers in the following section.

6. The CPA firm of Mercer & Bark performs audits of public companies. The firm is registered with the Public Company Accounting Oversight Board (PCAOB) and undergoes PCAOB inspections. How will this affect the firm's quality control effort?

   a. It will satisfy AICPA peer review requirements, so the firm will not need additional peer review.

   b. It will focus on the firm's SEC practice, so more additional peer review is needed for the rest of the firm's accounting and auditing practice.

   c. The firm will need to join the AICPA's SEC Practice Section (SECPS) to attain all the necessary quality reviews it will need.

   d. The firm will also need to join the Governmental Audit Quality Center (GAQC).

7. How might a third party benefit from the CPA firm undergoing peer review?

   a. The ability to turn around a negative situation.

   b. Use of the review for marketing.

   c. Making CPA firms more similar so all are perform quality engagements.

   d. More accurate and complete financial information.

8. What is one of the responsibilities of a firm enrolled in the AICPA Peer Review Program?

   a. To adopt a QC system designed by a third party.

   b. Satisfy its obligations related to client confidentiality.

   c. Accept a peer reviewer to perform its peer review.

   d. Provide oral representations of matters significant to peer review.

9. Which of the following firms is required to have an engagement review?

   a. The Northern Firm performs Yellow Book audits.

   b. The Southern Firm performs a compliance attestation engagement under AT-C 205 and AT-C 315.

   c. The Eastern Firm performs a general agreed-upon procedures engagement under AT-C 215.

   d. The Western Firm performs audit engagements under the Statements on Auditing Standards (SASs).

10. Which of the following statements most accurately describes the timing of a peer review?

    a. Peer reviews must be completed by the end of the peer review period.

    b. Subsequent peer reviews are due three years and six months after the end of the previous peer review period.

    c. Firms can temporarily change their year-end for subsequent peer reviews as long as the due date is still met.

    d. The administering entity will make sure any change in due date is approved by other applicable organizations.

SELF-STUDY ANSWERS

This section provides the correct answers to the self-study quiz. If you answered a question incorrectly, reread the appropriate material. **(References are in parentheses.)**

6. The CPA firm of Mercer & Bark performs audits of public companies. The firm is registered with the Public Company Accounting Oversight Board (PCAOB) and undergoes PCAOB inspections. How will this affect the firm's quality control effort? **(Page 28)**

    a. It will satisfy AICPA peer review requirements, so the firm will not need additional peer review. [This answer is incorrect. PCAOB inspections do *not* satisfy AICPA membership requirements or all state licensing requirements. Neither do PCAOB inspections satisfy quality review requirements of other regulatory agencies such as the GAO FDIC. Therefore, Mercer & Bark will likely require additional peer review to meet the requirements of these other entities.]

    b. It will focus on the firm's SEC practice, so more additional peer review is needed for the rest of the firm's accounting and auditing practice. [This answer is correct. The PCAOB's jurisdiction relates only to a registered firm's SEC practice, not to its entire practice. Therefore; Mercer & Bark will need to expand its quality control and peer review beyond what is required by the PCAOB to be in compliance with SQCS No. 8 and other requirements.]

    c. The firm will need to join the AICPA's SEC Practice Section (SECPS) to attain all the necessary quality reviews it will need. [This answer is incorrect. With the PCAOB conducting inspections of registered firms' public company practices, the role of the AICPA's SECPS with respect to such reviews is no longer required. Therefore, Mercer & Bark will not need to retain membership in the SECPS.]

    d. The firm will also need to join the Governmental Audit Quality Center (GAQC). [This answer is incorrect. *Government Auditing Standards* (Yellow Book) require that a CPA firm conducting audits under the Yellow Book have an external quality control review at least once every three years. The AICPA has established the GAQC, a web-based organization for CPA firms that perform Yellow Book audits. The GAQC provides members a means of finding training, guidelines, and other resources for improving audit quality. However, joining the GAQC is not necessary for Mercer & Bark in the scenario outlined above. Based on what we know, Mercer & Bark does not perform Yellow Book audits, so the GAQC does not apply in that regard. Also, even if the firm did perform such audits, governmental audits make up a different practice area from audits of public companies, so it would not apply in that regard, either.]

7. How might a third party benefit from the CPA firm undergoing peer review? **(Page 32)**

    a. The ability to turn around a negative situation. [This answer is incorrect. The ability to turn a negative situation around is a benefit that the firm can receive from undergoing peer review. If the firm has a less than successful result on its peer review, it can correct the identified problems and then know that its QC system is operating affectively.]

    b. Use of the review for marketing. [This answer is incorrect. The use of a successfully completed peer review in a marketing program is a way that CPA firms can benefit from undergoing peer review. Firms may prominently mention on their website, in business proposals, through a press release, etc., the successful completion of their peer review. Additionally firms may describe the peer review process, benefits, and significance of passing peer review.]

    c. Making CPA firms more similar so all are perform quality engagements. [This answer is incorrect. One benefit third parties can receive from the peer review progress is that it permits potential clients to compare CPA firms that are proposing to perform audit or accounting services. This will allow the potential clients to distinguish between the CPA firms, not make them more the same.]

    d. More accurate and complete financial information. [This answer is correct. One benefit to third parties is that, since the firm is regularly undergoing scrutiny of its accounting and auditing process, it will be able to better provide accurate and complete financial information to its clients.]

8. What is one of the responsibilities of a firm enrolled in the AICPA Peer Review Program? **(Page 33)**

   a. To adopt a QC system designed by a third party. [This answer is incorrect. To enroll in the program, a firm should design and comply with a QC system 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. That QC system does not need to be designed by a third party.]

   b. Satisfy its obligations related to client confidentiality. [This answer is correct. One of the responsibilities of a firm that is enrolled in the AICPA Peer Review Program is to take appropriate measures 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 for peer reviews.]

   c. Accept a peer reviewer to perform its peer review. [This answer is incorrect. The firm engages its own peer reviewer, it does not have to accept a specific one. The peer reviewer will perform the firm's peer review in accordance with the AICPA *Standards for Performing and Reporting on Peer Reviews*, in a timely manner.]

   d. Provide oral representations of matters significant to peer review. [This answer is incorrect. The firm is responsible for providing written representations, not oral, to describe matters significant to peer review.]

9. Which of the following firms is required to have an engagement review? **(Page 35)**

   a. The Northern Firm performs Yellow Book audits. [This answer is incorrect. Performing financial audits under *Government Auditing Standards* requires a firm, such as the Northern Firm, to have a system review, not an engagement review.]

   b. The Southern Firm performs a compliance attestation engagement under AT-C 205 and AT-C 315. [This answer is incorrect. Examinations performed under AT-C 205 and AT-C 315 (compliance attestation engagements), such as the one performed by the Southern Firm, require a firm to have a system review instead of an engagement review.]

   c. The Eastern Firm performs a general agreed-upon procedures engagement under AT-C 215. [This answer is correct. If the highest level of service a firm performs is general agreed-upon procedures engagements under AT-C 215, like the Eastern Firm, it can have an engagement review instead of the more intensive system review.]

   d. The Western Firm performs audit engagements under the Statements on Auditing Standards (SASs). [This answer is incorrect. Performing audits under the SASs, including integrated audits, requires a firm, such as the Western Firm, to have a system review, not an engagement review.]

10. Which of the following statements most accurately describes the timing of a peer review? **(Page 36)**

    a. Peer reviews must be completed by the end of the peer review period. [This answer is incorrect. The peer review period covers a period of one year mutually agreed on by the reviewer and reviewed firm. Peer reviews cover this period and ordinarily are performed within three to five months after the end of the year to be reviewed.]

    b. Subsequent peer reviews are due three years and six months after the end of the previous peer review period. [This answer is correct. Per the Peer Review Standards, the due date for each subsequent peer review is three years and six months after the end of the period covered by the previous review.]

c. Firms can temporarily change their year-end for subsequent peer reviews as long as the due date is still met. [This answer is incorrect. Firms are expected to maintain the same year-end on subsequent peer reviews. Occasionally, however, a firm may encounter a circumstance that prompts it to request a permanent change in its peer review year-end. However, such a change would not be temporary, and firm will not be granted a change if it would negatively impact the public interest.]

d. The administering entity will make sure any change in due date is approved by other applicable organizations. [This answer is incorrect. The firm, not the administering entity, is responsible to ensure that any administering entity-approved change in peer review year-end or due date is also approved by any other organization that requires it to have a peer review. Typically this may include state boards of accountancy, the Government Accountability Office, and other regulators.]

HAVING A SYSTEM REVIEW

Firms Required to Have a System Review

Whether a firm is required to undergo a system review or an engagement review is based on the types of accounting and auditing services the firm provides. How a firm can determine if it is subject to a system or engagement review (or any peer review) was discussed earlier in this lesson. This course focuses on system reviews; therefore, undergoing an engagement review is beyond the scope of this course. Because firms are required to establish and maintain a system of quality control, firms not required to undergo a system review may nevertheless choose to do so as a means of obtaining assurance about whether their QC system complies with professional standards.

Objectives of the System Review

Before discussing planning considerations, a brief overview of a the objectives of a system review is necessary. A system review is designed to test a reasonable cross-section of a firm's engagements, focusing on those that are high-risk, in addition to significant risk areas where it is more likely that engagements are not being performed and/or reported on in conformity with applicable professional standards in all material respects. A system review does not test every engagement or compliance with every professional standard. Neither does it test all detailed components of the firm's system of quality control.

The objectives of system reviews are to determine whether—

a. The reviewed firm's system of quality control has been designed in accordance with quality control standards established by the AICPA, currently SQCS No. 8.

b. The reviewed firm's quality control policies and procedures have been complied with.

The first objective is accomplished by performing a study and evaluation of the firm's QC system to ensure that it has been designed in accordance with QC 10 and by considering whether the firm's QC system is suitably designed for the firm's size and the nature of its practice. The second objective, ensuring that the firm is complying with its QC system, is accomplished by performing compliance testing of the QC system. Further discussion of reviewing the firm's QC system design and determining if the firm's QC policies and procedures are being complied with is provided later in this lesson.

System reviews are conducted in a manner similar to an audit—they involve planning (including a risk assessment), fieldwork, and issuance of a report. The reviewers use standard programs, checklists, and forms provided by the PR Board for guidance in setting the scope of the review and in designing the nature and extent of review procedures to perform. Unlike audits, however, peer review reports must be reviewed and approved by the administering entity before the review is accepted. (The PR Board does not review and approve peer review reports, but it does perform oversight of a percentage of completed peer reviews.)

Planning Considerations

An administering entity cannot schedule a review and a peer reviewer cannot conduct a review of a firm without obtaining certain background information on the firm in advance of the review. Additionally, prior to a firm scheduling its initial peer review under the AICPA Peer Review Program, the firm is required to enroll in the Program. (Information regarding the importance of enrolling timely in the Peer Review Program is provided later in this discussion.) As a result, firms need to be prepared to devote an appropriate amount of time and effort to the planning phase of the review. The following paragraphs discuss the administrative aspects that firms will be involved in as they prepare for their reviews.

Designate a Member of the Firm to Coordinate the Review. There are many administrative steps a firm needs to perform while planning for and undergoing the actual review. Also, there will be ongoing communication before, during, and after the review with the review team captain. Accordingly, the firm needs to select a coordinator to provide needed assistance to the review team and handle communications. Normally, the firm's quality control director is a good choice to coordinate the peer review.

Administering Entity. The AICPA Peer Review Program is administered by the PR Board, which establishes the peer review standards and interpretations, and provides direction and guidance that enrolled firms and peer reviewers are required to comply with to participate in the peer review program. The individual peer reviews are supervised and the reports are reviewed and approved by peer review committees of state societies or groups of state societies referred to as administering entities.

The review and approval of peer review reports is the responsibility of the administering entity. Generally, the administering entity will contact the firm about six months before the due date of the firm's review to begin to make arrangements for the review. At that time, the firm completes and submits online in PRIMA, the "Peer Review Information Form" (PRIF). The PRIF includes background and organizational information, as well as specific information about the firm's accounting and auditing practice. Certain information may already be pre-populated based on the firm's previous peer review and the firm needs to ensure such information is correct.

The PR Board will start collecting information annually by requiring firms to submit a PRIF each year, beginning the year after a firm's peer review year ending May 1, 2019. The timing of the annual PRIF requests will coincide with a firm's peer review year. For example, if a firm's most recent peer review year end is December 31, 2018, the annual PRIF submission will not be required until the next peer review period of January–December of 2021. However, if a firm's next peer review year end is May 31, 2019, submission of the PRIF will be required to schedule that review and annually for each year afterward. Firms will be subject to noncooperation procedures if the PRIF is not submitted as required.

However, before an administering entity will contact the firm about scheduling its first peer review, the firm must have enrolled in the AICPA Peer Review Program. If the firm has not enrolled, the administering entity has no way to know that the firm needs a peer review and so the firm will not get added to the administering entity's peer review schedule. This is the case, even if the firm has been contacted by their state board indicating a date by which the firm needs a peer review. As a result, it is not uncommon for a firm's first peer review to be delayed for months when the firm does not enroll in the Peer Review Program in a sufficient amount of time prior to when it desires to have its first peer review conducted. Accordingly, it is a best practice for a firm to enroll in the Peer Review Program as soon as it becomes aware that a peer review is needed or desired. Additionally, according to the PR Board's peer review program question and answer document, a firm should enroll in the program by the report date of the initial engagement that caused the firm to fall within the scope of the AICPA's practice-monitoring standards. Firms now enroll in the AICPA Peer Review Program by logging into the PRIMA system.

Types of Review Teams. The AICPA Peer Review Program provides firms with two options for organizing a system review team: *firm-on-firm* or an *association* of CPA firms. The following paragraphs discuss arranging firm-on-firm and association reviews.

Firms that are not members of an association have only the option of a firm-on-firm review, while firms that are members of an association may have either an association review or a firm-on-firm review. In a firm-on-firm review, the reviewed firm selects another CPA firm to conduct its review. Fee considerations lead many firms to prefer a firm-on-firm review team where the firm has the ability to negotiate the fee with the reviewing firm and may even establish a fixed fee. As the reviewing firm may continue to perform the reviews on a continuing basis, there is a potential for future cost savings as the reviewers become more familiar with the firm and, therefore, more efficient.

Firms that belong to associations may ask their association to assist in forming a review team. Some associations require a member firm to have its peer review arranged by the association as a condition of membership. A member firm of an association may conduct a peer review of another association-member firm, provided that the association receives annual approval from the PR Board. Such approval must be in place before any aspect of a peer review can be planned, scheduled, or performed. Additionally, all association-related review teams must still be approved by the administering entity.

Considerations when selecting a reviewing firm include the following:

- Size of the reviewing firm.
- Geographical proximity of the two firms.

- Independence of the reviewing firm.

- Administering entity approval of the reviewing firm.

Size of the Reviewing Firm. The size of the reviewing firm is important in that a firm prefers to be reviewed by a firm that understands and relates to its practice. It is a best practice to choose a firm that has a similar practice, but is slightly larger. A slightly larger firm can usually relate to the growing pains the firm is likely to experience and perhaps identify problem areas in the early stages.

Geographic Proximity of the Two Firms. Geographic proximity of the two firms may be a consideration in a firm-on-firm review team because many local firms do not want a firm that competes with their practice to perform the review, they choose a firm that practices in another city. However, this factor is somewhat offset by having to incur the travel expenses for out-of-town reviewers. For this reason, some firms elect to have their peer reviews performed by firms from their own city.

Independence of the Reviewing Firm. An important consideration is that the firm selected must be independent of the reviewed firm and free of conflicts of interest with both the firm and clients whose engagements are selected for review. In fact, Interpretation No. 21-1 of the Peer Review Standards precludes firms from performing reciprocal reviews. A *reciprocal review* occurs when (a) a firm performs a review of the firm that performed its most recent review or (b) a reviewer serves on a review team carrying out a review of a firm whose personnel participated in the most recent review of that reviewer's firm.

Interpretation Nos. 21-1 through 21-23 of the Peer Review Standards provide guidance on identifying independence issues, describing various situations in which independence impairments with a reviewing firm can occur. Following are just a few of the numerous independence situations described:

- Firm A performs for Firm B, a quality control document review and/or a preliminary quality control procedures review. Firm A may then only perform a peer review of Firm B when those other QC-related services were not performed for the year immediately preceding or during the peer review year [Interpretation No. 21-3 (PR 9100.21-3)].

- Firm A performs a preissuance review on one of Firm B's reports and accompanying financial statements for an accounting or auditing engagement during the period since the last peer review year-end. Firm A can perform the peer review of Firm B, *unless* the preissuance review was performed on an engagement that was within the year immediately preceding or during the peer review year. [Interpretation No. 21-4 (PR 9100.21-4)].

- Firm A audits the financial statements of Firm B's pension plan. Provided that the fees incurred for the audit were not material to either firm, either firm could perform a peer review of the other [Interpretation No. 21-5 (PR 9100.21-5)].

- Firm A occasionally consults with Firm B with respect to specific accounting, auditing, or financial reporting matters. Firm A and B are considered independent of each other unless the frequency and extent of the consultation are such that Firm B becomes an integral part of Firm A's consultation process [Interpretation No. 21-8 (PR 9100.21-8)].

Independence Guidance for Networks and Network Firms. Network firms and employees and owners of those firms are prohibited from performing the peer reviews of firms within the same *network* [as defined in the independence interpretation, *Networks and Network Firms* (ET 1.220.010)]. Peer Review Standards Interpretation No. 26-2 (PR 9100.26-2) reflects that information.

Administering Entity Approval of the Reviewing Firm. Approximately five months before the review is expected to begin, the reviewed firm selects a reviewer in PRIMA. An email request is sent directly to the reviewer, who confirms acceptance of the review in PRIMA, if appropriate. After the reviewer confirms his or her acceptance of the review, scheduling checks commence. The scheduling checks may produce errors, such as mismatched industries, in which case the review is electronically returned to the firm. The firm then needs to contact the reviewer selected to determine if the reviewer can rectify the error, for example, by replacing a team member with an individual who has the requisite industry knowledge/experience. If no scheduling errors are generated, the review passes electronically to the administering entity for official approval and generation of approval letters that are distributed to the reviewed firm and reviewer.

As a result of recent changes made by the PR Board in determining whether a peer reviewer has the appropriate current industry experience to perform a specific peer review, it now may take longer to find a reviewer qualified to perform a review for firms that perform audits of certain industries. Accordingly, it is a good idea for firms to start their reviewer selection process earlier to ensure that a reviewer is approved timely by the administering entity in case there is a delay in locating a reviewer with appropriate experience. Due to the recent changes, firms should not assume that engaging the firm's previous peer reviewer will automatically result in administering entity approval.

Choosing a Peer Reviewer. The reviewed firm has the responsibility to determine if the peer reviewer has the experience needed to perform its peer review. A peer reviewer should have experience in similar industries, as well as a sufficient amount and type of experience. Since the reviewed firm selects its peer reviewer, the firm may also specify other certain criteria regarding the review team, such as how the team is organized, special expertise of review team members, and the geographic location of the review team. A review team is comprised of one or more individuals, depending upon the size and nature of the firm's practice.

When selecting a reviewer to perform the firm's peer review, the firm might consider asking the following questions:

- How many reviews has the individual performed?
- How much current experience and training does the reviewer have in the services and industries in which the firm performs engagements?
- If the reviewer does not have relevant experience in all of the services and industries in which the firm performs engagements, does he or she have a team member who does?
- Will the reviewer be able to complete the review on time, allowing the firm adequate time to submit the report and letter of response, if any, to the administering entity by the firm's review due date?
- Will the reviewer provide a list of firms for which he or she has conducted peer reviews?
- What type of government and/or ERISA audits does the peer reviewer perform (if applicable to the firm's practice)?
- Does the reviewer satisfy all the requirements and qualifications to be a peer reviewer? (Firms should be aware that the PR Board has recently revised the reviewer training and qualification requirements.)
- Has the individual's ability to be a reviewer been limited or restricted?
- Has the reviewer received any notification of limitations or restrictions on their ability to practice public accounting by a regulatory, monitoring, or enforcement body?

Firms that are members of the Governmental Audit Quality Center and/or Employee Benefit Plan Audit Quality Center have a membership requirement to have a quality center member review the GAO and/or ERISA engagements.

All members of the review team are approved by the administering entity prior to the beginning of the peer review. In addition, the administering entity has the authority to determine whether a reviewer or review team's experience is sufficient to perform a particular review, which, due to recent reviewer qualification changes in the Peer Review Program, may now take longer (as discussed above). The administering entity can provide a list of firms that offer peer review services in a specific geographic area. Additionally, the AICPA maintains a reviewer search feature available on the AICPA Peer Review Program web page that can be used to search for reviewers by city, state, industry, and/or practice areas.

Review Team Areas of Experience. If the firm being reviewed practices in certain areas, the review team must include a reviewer with experience in those areas. The following practice areas apply to all levels of service, while the industry differentiation is only pertinent to audit engagements or examinations.

Practice areas:
- Engagements under the SSARS
- Prospective financial information
- Single Audit Act engagements under *Government Auditing Standards* (Yellow Book)

Practice areas(continued):
- Audits under *Government Auditing Standards* (Yellow Book)
- Audits under FDICIA
- Audits under ERISA
- Other audits
- Reporting on controls at a service organization (SOC 1, SOC 2, or SOC 3 reports)
- Other attestation services

Industries:
- Agricultural, livestock, forestry, and fishing
- Airlines
- Auto dealerships
- Banking
- Broker-dealers—carrying
- Broker-dealers—noncarrying
- Casinos
- Colleges and universities
- Common interest realty associations
- Construction contractors
- Credit unions
- Defined contribution plan, full and limited scope (403b plans only)
- Defined contribution plan, full and limited scope (excluding 403b plans)
- Defined benefit plan, full and limited scope
- ERISA health and welfare plan
- ESOP plans
- Extractive industries—oil and gas
- Extractive industries—mining
- Finance companies
- Franchisors
- Government contractors
- Health maintenance organizations
- Hospitals
- HUD programs
- Investment companies and mutual funds
- Life insurance companies
- Mortgage banking
- Not-for-profit organizations (including voluntary health and welfare organizations)
- Nursing homes
- Other ERISA plans
- Personal financial statements
- Property and casualty insurance companies
- Real estate investment trusts
- Reinsurance companies
- Rural utilities service borrowers
- Savings and loan associations
- School districts
- State and local governments
- Telephone companies
- Utilities

Reviewers who undertake to review engagements in high-risk or complex industries who do not have recent experience in those industries may be called upon to justify why they should be permitted to review those engagements. In addition, a reviewer of high-risk industry engagements should possess not only current knowledge of professional standards, but also current knowledge of any accounting practices specific to that industry. The administering entities have the authority to decide if the reviewer's experience is sufficient. Administering entities ask approximately one-third of team captains each year to provide written evidence of their recent experience in the industries on their resumes. A listing of reviewer qualifications is located at Appendix B of the *Questions and Answers about the AICPA Peer Review Program* document discussed earlier in this lesson.

Select a Date for the Review. The specific rules regarding the timing of peer reviews were summarized earlier in this lesson. Generally, those rules specify the due date of the review. The term *due date* is defined by the Peer Review Standards as the date by which all required review documents should be completed and submitted to the administering entity. Even though the due date is established by the administering entity, the firm coordinates the specific dates for the fieldwork with the team captain. Also, regulatory agencies that require peer reviews, such as the Government Accountability Office and state boards of accountancy, may have review completion dates that differ from AICPA timing rules, including required completion dates that are earlier than those established under the AICPA rules. Firms that are subject to peer review by a regulatory agency need to consider the agency's timing requirements and discuss them with the reviewing firm and the administering entity.

Extensions. If the firm is unable to complete its review by the required due date (that is, the date by which all required review documents should be completed and submitted to the administering entity), it needs to request an extension in PRIMA before the due date. If possible, extensions should be requested by at least 60 days prior to the due date. Generally, extensions requested after the firm's peer review due date has passed will not be granted. The extension information needs to cite the reasons why the firm cannot complete the review on time and offer an alternative date. Extensions of a review date by more than three months are rare. In certain circumstances, extensions will be granted following a merger or dissolution.

Extension requests are considered on a case-by-case basis. The following list represents some of the common reasons that an extension was granted:

- To firms that are considered new firms as a result of a merger or dissolution.
- To enable a firm to complete a major engagement (1 to 2 months granted).
- When the timing of the review conflicts with the firm's busy season (1 to 2 months granted).
- To small firms because of the absence, loss, or turnover of personnel crucial to the conduct of the review.
- When a firm's records or offices have been severely damaged or destroyed by a natural catastrophe.
- When a firm has selected a reviewer who, because of a scheduling conflict, cannot complete the review by the due date but is available to complete the review later in the calendar year.

Extensions requested because the firm is relocating or renovating its offices or for failure to have a QC system in place are generally not granted. Extensions for peer reviews intended to meet the peer review requirements of *Government Auditing Standards* can be granted for up to three months by the AICPA's administering entity. However, based on Paragraph 3.97 of the Yellow Book, extensions beyond three months can only be granted by the administering entity and the Government Accountability Office (GAO).

If the firm has not had adequate time to develop and implement its QC system, using practice aids such as those in *PPC's Guide to Quality Control* can help to reduce start-up time. The firm should start by documenting its QC system and identifying any problems related to the design of the system. Performing an in-house inspection four to six months prior to the end of the firm's review period will also help to identify problem areas.

Establish the Year End of the Period to Be Reviewed. The peer review program does not specify the year end to be covered by the review, except to state that it must cover a current 12-month period mutually agreed on by the reviewed firm and the review team captain. The review year end does not have to coincide with the firm's fiscal year end. Also, the client engagements selected by the review team for review will be those with periods ending during the review year, except for financial forecasts or projections and agreed-upon procedures, the selection of which is based on the report date. If a current year's engagement that is selected 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. In the situation where the subsequent year's engagement has been completed and issued, the review team may consider (based on its assessment of peer review risk), whether it is more appropriate to review the more recently completed and issued engagement instead.

To determine the most advantageous review year end, the following factors may be considered to the extent practical (different firms will give different weight to each factor):

a. Initial Reviews:

   (1) *Requirement of the Review Program.* Rules adopted by the PR Board will dictate either when the fieldwork must commence or when the review must be completed.

   (2) *The Length of Time the Firm Has Operated under Its QC System.* It is generally preferable that a firm operate under its QC system for at least one year prior to its first review, so the date the firm's quality control system was implemented (or significantly changed) may be considered. For example, a firm

that implemented its system July 1st of the previous year would generally not select a review year end earlier than June 30th of the current year.

(3) *Clients' Year Ends.* The number and types of clients and their year ends is an important consideration. For example, audits of large clients with June year ends, if not completed on a timely basis, could delay the review into the late months of the year. In those instances, a May (or earlier) review year end may be preferable.

(4) *The Firm's Workload.* It is best for the firm and the reviewer if the peer review is performed during a slower period for the firm. The review is generally conducted three to four months after the end of the review year.

(5) *Reviewers' Needs.* Reviewers may be able to perform the review only during certain periods.

(6) *Government Auditing Standards*. See discussion at b.(3) below.

b. Subsequent Reviews:

(1) *Requirements of the Review Program.* A firm's subsequent reviews should be completed (the date by which all required review documents should be completed and submitted to the administering entity) within three years and six months from the end of the period covered by the previous peer review. The review year end for subsequent reviews is expected to be the same as that of the previous review. If a firm wishes to change its review year end, the firm must obtain the approval of its administering entity.

(2) *Changes in the Firm's Practice or Other Circumstances.* While it is generally expected that a firm's review year end will not change, the items listed in a. for initial reviews may be considered, as applicable, at each subsequent review date.

(3) *Government Auditing Standards*. For peer reviews intended to meet the peer review requirements of *Government Auditing Standards*, Chapter 3 of the Yellow Book requires that an audit firm have an external review conducted within three years from the date the firm starts field work on its first engagement under the Yellow Book. The Yellow Book also indicates that subsequent external peer reviews must be conducted every three years. It is a best practice for the firm to communicate with the GAO regarding a change in peer review year end that would extend its peer review period beyond three years from the last review.

Sign an Engagement Letter. Once the review team has been selected and the review dates established, the team captain will send the firm an engagement letter. This letter needs to be carefully read and signed by the managing partner or other designated person. The engagement letter will *ordinarily* include the following items:

a. Timing of the review.

b. Statement of fee and clarification regarding expense reimbursement.

c. Names of the team captain and other team members, if known.

d. Standard clauses stating that:

(1) The review will be conducted in accordance with applicable peer review standards, and the firm will be required to provide a representation letter to the reviewer.

(2) The reviewed firm will obtain the permission of clients to have workpapers reviewed (if necessary).

(3) Reviewers do not have client contact.

(4) Inclusion of "hold harmless" paragraph regarding subpoena to testify on review.

(5) The PR Board has established a policy that a firm may not resign from the peer review program during the course of its peer review except as set forth in the Interpretations of the *Standards for Performing and Reporting on Peer Reviews*.

Firms subject to the review requirements of the FDIC Improvement Act of 1991 may wish to include in the engagement letter statements that the review is intended to comply with the review requirements of the FDIC Improvement Act of 1991 and that the review workpapers will be made available for review by the FDIC if requested. [Regulations implementing the FDIC Improvement Act of 1991 (FDICIA) require that federally insured depository institutions with $500 million or more in total assets at the beginning of the fiscal year be audited and that the auditors participate in a practice monitoring program. Participation in an AICPA practice monitoring program or an equivalent program that allows FDIC review of the review workpapers meets this requirement.]

Submit Background Information about the Firm to the Team Captain. Just as with an audit engagement, the reviewers will perform a certain amount of planning before they arrive for the fieldwork phase of the review. During the planning phase, the team captain will inquire of the firm regarding the nature of the matters to be addressed in the written representation. The team captain will also request information about the firm and its accounting and auditing practice to aid in planning the scope of the review, determining the nature and extent of review procedures, and making a preliminary selection of engagements to review. The team captain will contact the firm and request this information in time to receive it sufficiently in advance of the review. Team captains will generally request that the firm provide the following as soon as possible (at a minimum):

a. The firm's quality control document in effect for the peer review year. (Effective for peer reviews commencing on or after January 1, 2017, the AICPA has removed the "Quality Control Policies and Procedures Questionnaires" that were previously available at PRPM sections 4300 and 4400. Firms are expected to have developed their own QC documents that have been in effect for the year under review.)

b. Relevant engagement manuals, checklists, etc.

c. Partner resumes and background information.

d. A list of the firm's professional personnel, showing name, position, and years of experience with the firm and in total.

e. A complete list of each of the firm's accounting and auditing client engagements, regardless of whether the engagement reports are issued, and prepared in the format shown in Appendix B of PRPM 4100 categorized by service type (audit, attestation, review, compilation, and preparation). It is good practice that firms provide the information to their reviewer in Excel format to enable the reviewer to more easily work with the information or change it based on discussion with the firm during planning. (How the firm ensures completeness of its engagement listing is something that reviewers will ordinarily inquire about, and firms are now required to include a representation that affirms the completeness of the engagement listing. Additionally, not providing a complete listing of the firm's engagements to reviewers is an action that could result in the firm being deemed as noncooperative, leading to termination from the peer review program, as further discussed later in this lesson.) Each engagement on the list should include information about—

   (1) A client identifier, such as "client code."

   (2) The period covered or year-end date of the financial statements.

   (3) The level of service provided to the client.

   (4) Whether it was an initial engagement.

   (5) The client's industry and the practice area, identified by using codes provided in PRIMA.

   (6) Whether the client has foreign operations.

   (7) The engagement partner.

   (8) The approximate total number of attest engagement hours.

   (9) Whether it is an initial engagement.

   (10) Other information the reviewer may request.

Each engagement for a client is to be listed, not just the highest level of service. However, it seems logical to list monthly services as one engagement (rather than listing each month's services) as long as it is clear, for example, that the services include (1) eleven monthly write-up services and financial statements without full disclosure and (2) one year-end compiled financial statements with full disclosure.

f. A list of the firm's key quality control personnel, such as the Quality Control Director, Human Resources Director, and the individual in charge of monitoring.

g. The firm's latest peer review report; letter of response, if applicable; and the letter of report acceptance from the administering entity. (The reviewer may alternatively obtain this information directly from the administering entity.)

h. Other information requested by the team captain.

Some of the items listed above are discussed in more detail later in this lesson.

At the time the review team arrives at the firm's office, the following additional information should be available:

a. Engagements for the year under review, including applicable documentation required by professional standards and reports issued in connection with the engagements.

b. Completed profile sheets for the engagements selected in advance for review by the team captain.

c. A copy of the firm's inspection/monitoring documentation for each year since the firm's last peer review.

d. Latest independence representations from firm personnel required to be independent.

e. Documentation of independence consultations, including the final resolution.

f. Documentation regarding the independence of any correspondent firms used during the year under review.

g. Personnel files to the extent requested by the team captain.

h. Documentation of firm and individual licenses, including for states other than where the firm's main office is located and for states other than where an individual primarily provides services.

i. CPE records for all personnel for the three most recent educational years.

j. Documentation of CPE programs developed and/or presented in-house.

k. Most recent peer review report of the firm's quality control materials (QCM) provider, if the firm uses third-party QCM (such as PPC *Guides*).

l. Documentation regarding consultations with outside parties on accounting and auditing matters.

m. Personnel manuals.

n. Scheduling or staffing plans.

o. Recruitment and hiring plans.

p. Communications relating to allegations or investigations of deficiencies (including litigation) in the conduct of an accounting, audit, or attestation engagement performed and reported on by the firm since the firm's last peer review.

Accounting and Auditing Hours. Questions often arise as to what is to be included in the accounting and auditing hours (A&A hours) referred to in item e. of the "Submit Background Information about the Firm to the Team Captain" paragraph above. This question might more easily be answered by explaining what it does not include. A&A hours do not include tax return preparation, consulting services, bookkeeping, payroll services, other nonattest services, or administrative services (such as typing or data entry).

Excluding Engagements or Functional Areas from Scope of Peer Review. Interpretation No. 55-1 of the Peer Review Standards (PR 9011.55-1) notes that in rare situations a reviewed firm may have legitimate reasons for excluding an engagement or certain aspects of functional areas from the scope of the peer review, such as an engagement or an employee's personnel records that are subject to litigation. In those situations, the reviewed firm should notify the team captain in a timely manner and submit a written statement to the administering entity, before the review begins, indicating (a) that it plans to exclude an engagement(s) or aspect(s) of a functional area(s) from the peer review selection process, (b) the reasons for the exclusion, and (c) that it is requesting a waiver from a scope limitation in the peer review report. The administering entity will have to be satisfied about the reasonableness of the explanation before agreeing that a scope limitation is not required.

Firm Use of QCM. When a firm uses QCM in its accounting and auditing practice, the QCM becomes an integral part of the firm's system of quality control. Accordingly, the QCM becomes a consideration for the firm's peer review, especially in the area of engagement performance. Firms using QCM need to ensure that the QCM is appropriate for its accounting and auditing practice. During peer review, the reviewer will assess the reliability and suitability of the QCM and the firm's policies and procedures for adopting (or developing), updating, and modifying the QCM it uses, whether purchased from a third-party provider or developed internally. (It is also possible for firms to tailor QCM purchased from a third party for their own needs.) A firm that uses third-party QCM also needs to—

- Provide to its peer reviewer the most recent peer review report of the QCM provider.
- Know that significantly altered QCM (even QCM with a peer review report of *pass*), may require the firm's peer reviewer to consider the appropriateness of the firm's engagement methodology.
- Know that if the peer review report of the QCM provider is other than *pass*, the firm's peer reviewer cannot automatically place reliance on the appropriateness of the QCM for the firm's system of quality control. Instead, the peer reviewer may be required to consider the appropriateness of the firm's engagement methodology.
- Know that if the QCM provider received a *pass with deficiencies* report, the firm's peer reviewer will be required to perform additional work with regards to how the QCM deficiencies impact the firm's QC system and the extent of reliance that can be placed on the QCM.
- Know that if the QCM provider received a *fail* report, the firm's peer reviewer cannot place any reliance on the QCM as reliable aids for the firm's system of quality control.

Additional Information. The firm *may be requested* to provide additional information such as the following:

a. Description of the firm's organization.

b. Statement of firm philosophy, including:

   (1) Firm goals and objectives.

   (2) Operating practices regarding services to clients and development of personnel.

   (3) Policies relating to industry specialization or practice specialties.

   (4) Operating autonomy of practice offices; i.e., the extent of decentralization of authority.

c. Firm profile, including:

   (1) Firm management-level personnel (other than partners) detailing each individual's years with the firm and areas of expertise.

   (2) Industry concentrations and specialty practice areas, such as regulated industries.

(3) Extent of use of correspondent firms on engagements.

(4) Extent of international practice.

(5) Description of recent mergers.

(6) Newly opened offices.

Review the *Peer Review Program Manual*. The AICPA *Peer Review Program Manual* provides guidance that can help a firm design a quality control system that meets the requirements of the AICPA Peer Review Program. Reviewing certain sections of the PRPM again as the review date approaches can also help the firm plan and prepare for the review. The PRPM provides insight as to how the reviewers will conduct the review. It establishes guidance for the reviewers in areas such as setting the scope of the review, determining the nature and extent of tests, the types of evidence and documentation to examine, and questions to direct to selected firm personnel in the interview phase of the review. As a word of caution, *the reviewers' checklists contained in the PRPM may include steps that go beyond the minimum QC procedures that are absolutely necessary, particularly for small firms.* Therefore, firms need to read the checklists with two thoughts in mind: (a) the checklists will usually be modified by the team captain to fit the firm's unique practice and operations, and (b) a "no" answer does not necessarily indicate that the firm has a weakness in its QC system. It would be advantageous for the firm to anticipate possible "no" answers and be prepared to defend the logic and practicality of its QC system.

Firms may not always have as much time as they would like to review the PRPM prior to commencement of peer review. However, at a minimum, reading PRPM Section 4100, "Instructions to Firms Having a System Review" will assist the firm in understanding its responsibilities before, during, and after the peer review. This document is available from the peer reviewer and many reviewers will furnish the document without being asked. Additionally, a firm may access Section 4100 of the PRPM from the following web page: **www.aicpa.org/InterestAreas/PeerReview/Resources/PeerReviewProgramManual/Pages/default.aspx**.

Conduct In-house Training before the Review

As the review date approaches, it may be helpful for firms to conduct in-house training to orient the partners and staff to the review process. Such training can be used to inform the firm's professional staff about what to expect during the review and to emphasize the firm's commitment to a quality practice. Since all accounting and auditing personnel will be directly or indirectly involved in the review, either in the staff interviews or through the review of their work on selected engagements, they need to be fully apprised of the review process and of the expectation for their complete cooperation.

Many of the firm's employees may regard a review with a great deal of apprehension. While this is a natural response, the persons conducting the in-house training can alleviate much of this anxiety by conveying a positive attitude and emphasizing the benefits of a review. A firm that approaches the review with an open mind and a positive attitude can turn the review experience into an opportunity to improve the efficiency, effectiveness, and quality of its operations. The following points can be covered in the orientation training:

- Identify the individual(s) in the firm who will act as the primary liaison between the firm and the review team.

- Discuss the peer review program in which the firm is participating. Describe the fieldwork stage of the review (i.e., study and evaluation of the firm's QC system, reviews of selected engagements, and interviews with firm personnel) and the resulting report. Mention that the firm may be required to formally respond to items found during the review and may need to take certain actions to correct *deficiencies* or *significant deficiencies* and/or to complete an implementation plan to address *findings*.

- Discuss how the firm selected the review team and the team members' backgrounds and expertise, if known.

- Describe the scope of the review, the types of evidence and documentation the reviewers will examine, how engagements are selected for review, and the types of questions that will be asked during the interviews with selected personnel. Emphasize that each person is expected to be familiar with the firm's quality control policies and procedures. Consider distributing copies of the personnel interview questionnaires from the reviewers' manual so that firm personnel can understand the types of questions that will be asked. (However, inform personnel that the team captain may modify the interview questions.)

- Explain that all discussions of engagements and/or quality control matters with the review team should ordinarily be done by the firm's liaison partner or in the presence of the liaison partner.

- Because the peer review process may create conflicts with client demands and deadlines, discuss the firm's expectations with regard to overtime and conflicts with client services.

Firm and Individual Licenses

Most states require firms to possess a firm license (also known as a *practice unit* license). Accordingly, sole practitioners are ordinarily responsible to possess two licenses: a firm license and an individual license to practice as a CPA. In all other firms, in addition to the one firm license, each professional in the firm who has passed the Uniform CPA Exam and has met the experience requirement of their state board is also required (in most states) to possess an individual CPA license. During peer review, a firm will be asked to provide written representation that the firm is in compliance with all licensing requirements and that firm members are in compliance with individual licensing requirements. In addition, a reviewer is required to verify the firm's practice unit license in the state the firm is domiciled and, for a sample of personnel, individual licenses in the state in which the individual primarily practices public accounting. Verification is met by the firm providing documentation from the licensing authority that the license is appropriate and active during the peer review year, and through the earlier of reviewed engagements' issuance dates or the date of peer review fieldwork. While verifying out-of-state practice or individual licenses is not required, the reviewer may choose to do so if the reviewer's understanding of the firm's quality control procedures relating to licensing causes him or her to believe there is a risk of noncompliance.

When a reviewer identifies that a firm does not possess the required license(s) to issue accounting and auditing reports, the peer reviewer is required to complete a Finding for Further Consideration (FFC) Form to indicate that fact. Additionally, the peer review committee will require an implementation plan for the firm to submit a valid license(s) to the committee. When a reviewer identifies that a partner or other employee with reporting responsibility does not have a current individual license to practice public accounting as required by the relevant state board(s) of accountancy, the peer reviewer is required to classify the engagement as not complying with professional standards. Peer reviewers will consider the nature, causes, pattern, pervasiveness, and relative importance to the firm's system of quality control in determining if the lack of an individual license qualifies as a systemic deficiency.

If the firm is not in compliance with all licensing requirements, the reviewer will consider the impact on the peer review and on the peer review report, if any. It is important for firms to ensure that both firm and individual licenses are in order prior to the beginning of the peer review. Because licensing requirements are periodically revised, firms need to verify that they are complying with all of the appropriate state boards of accountancy practice unit and individual licensing requirements.

Administrative Matters

Peer reviewers are often from out of town and have a short period of time to complete the fieldwork; therefore, it is in the best interest of the firm to accommodate the reviewers' work schedules. The review will go much smoother if the following details are taken care of in advance of the review team's arrival:

- Confirm the arrival and departure dates with the team captain. (Generally, the fieldwork dates will be stated in the engagement letter; however, it is wise to reconfirm those dates a week or two before the scheduled arrival.)

- If appropriate, make hotel accommodations and arrange for transportation to the office.

- Arrange for a comfortable, adequate work area with Internet access. Most firms use their conference rooms.

- Plan lunches and dinners for the team members.

- Assign an administrative person to the review team to assist in obtaining files, copying, scanning, etc.

As mentioned previously, the firm provides information to the team captain about its accounting and auditing clients in advance so that the engagements to be reviewed can be selected prior to the commencement of fieldwork. The team captain will notify the reviewed firm of the engagements selected no earlier than three weeks before the commencement of the review. The firm can have the workpapers, reports and financial statements, and any other pertinent files or correspondence ready upon the reviewers' arrival. All the engagements should be available to the team captain at the start of the review fieldwork. The team captain will also select at least one engagement for review after the review team begins fieldwork. The firm is not given advance notice of this surprise engagement. The surprise engagement is discussed further later in this lesson.

Client Confidentiality. The Peer Review Standards state that it is the *firm's* responsibility to ensure that all requirements regarding client confidentiality are satisfied. The *Confidential Client Information Rule* (ET 1.700.001) addresses confidential client information and provides an exception to the confidentiality requirements so that a review of a member's practice under AICPA authorization is allowed. Some state statutes or ethics rules established by state boards of accountancy, however, may not clearly provide such an exception. Firms need to consult their state society to determine what action, if any, is required by the firm.

Positive Enforcement Programs. A number of state boards of accountancy require various forms of quality control reviews in their respective states. These are commonly referred to as *positive enforcement programs*. The Peer Review Standards (PR 100.10) note that compliance with a positive enforcement program does not constitute compliance with the AICPA practice monitoring requirement for peer reviews. Many state boards require, or plan to require, a copy of the firm's peer review report and letter of response, if applicable. Although the Peer Review Standards require the reviewer to ask the state CPA society administering the review about the requirements of any applicable positive enforcement program, the firm is expected to also be aware of any such requirements. One example of such a requirement is the number of offices selected for testing during the peer review in a multioffice firm. The firm should consider confirming with the review team captain that any such requirements have been considered in planning the review. The firm should consult with its state society and state board, as necessary.

Planning Timetable

The timetable presented in Exhibit 2-2 summarizes the activities that generally take place before the fieldwork begins and the approximate dates on which this course suggests they occur. The timetable assumes a review year of April 1–March 31 and a fieldwork commencement date of July 15. Firms with other review periods can adjust the timetable accordingly.

Importance of the Commencement Date. A peer review generally commences when the review team begins fieldwork. However, a review can commence earlier. For example, in certain situations team members may begin to review engagements prior to the team captain beginning their fieldwork. In such a situation, the review has commenced prior to the beginning of fieldwork.

The term *commencement date* is important because it is used in various instances in the Peer Review Standards and Interpretations to determine when certain situations apply. Some instances include cooperating in a peer review, approval of the review team by the administering entity, and providing the surprise engagement to the firm. Additionally, it is important for the firm to recognize that once the review has commenced, the firm cannot resign from the AICPA Peer Review Program unless certain steps are followed which include the firm acknowledging its noncooperation and the AICPA publishing notice of the action.

Exhibit 2-2

Planning Timetable

February 15	Select the review firm. Establish the 12-month period to be covered by the review and the fieldwork dates. Provide any information requested by the team captain or state CPA society administering the review.
April 1	Sign and return the engagement letter.
May 15	Make necessary travel, hotel, and transportation accommodations.
June 15	Review the peer review program manual to obtain an understanding of the procedures the review team will perform.
June 15	Submit the firm background information to the team captain.
June 15	Arrange for work space and meals.
June 15	Gather all documentation related to the firm's QC system (e.g., QC document, independence representation letters, CPE records, and accounting and auditing manuals).
July 1	Confirm arrival date with the team captain.
July 1	Designate an administrative person to assist the review team as necessary.
July 1	Conduct in-house seminar for partners and staff about the review.
July 15	Commencement of fieldwork.

*   *   *

SELF-STUDY QUIZ

Determine the best answer for each question below. Then check your answers against the correct answers in the following section.

11. The firm of Greenblatt & Moscowitz needs to select a firm to perform its firm-on-firm peer review. Which of the following firms would most likely be the best choice?

    a. Firm A is slightly larger than Greenblatt & Moscowitz.

    b. Firm B is located in the same town as Greenblatt & Moscowitz and has a similar practice.

    c. Greenblatt & Moscowitz performed Firm C's most recent peer review.

    d. Firm D is a member of the same CPA association as Greenblatt & Moscowitz.

12. Which of the following information should be submitted to the review team captain prior to the review?

    a. A complete list of the firm's clients.

    b. A list of the firm's professional personnel.

    c. Documentation of individual and firm licenses.

    d. Three years of CPE records for firm personnel.

13. Which of the following is an action that the reviewed firm can take prior to the review that will help the review run more efficiently?

    a. Providing one of the review team members with access to obtain files and do any needed copying or scanning.

    b. Taking part in a positive enforcement program.

    c. Making hotel accommodations and arranging lunches and dinners for the review team.

    d. Providing the review team with information on keeping client information confidential.

14. Typically, what is considered the review's *commencement date*?

    a. The date the fieldwork begins.

    b. The date all review documents are sent to the administering entity.

    c. The date the engagement letter is signed.

    d. The date the firm provides in-house training to prepare for the review.

SELF-STUDY ANSWERS

This section provides the correct answers to the self-study quiz. If you answered a question incorrectly, reread the appropriate material. **(References are in parentheses.)**

11. The firm of Greenblatt & Moscowitz needs to select a firm to perform its firm-on-firm peer review. Which of the following firms would most likely be the best choice? **(Page 47)**

    a. Firm A is slightly larger than Greenblatt & Moscowitz. [This answer is correct. The size of the reviewing firm is important in that a firm prefers to be reviewed by a firm that understands and relates to its practice. It is a best practice to choose a firm that has a similar practice, but is slightly larger. A slightly larger firm can usually relate to the growing pains the firm is likely to experience and perhaps identify problem areas in the early stages.]

    b. Firm B is located in the same town as Greenblatt & Moscowitz and has a similar practice. [This answer is incorrect. Geographic proximity of the two firms is a consideration in a firm-on-firm team. Many local firms do not want a firm that competes with their practice to perform their review and, as a result, they choose a firm that practices in another city. In this scenario, Firm B would be a competitor due to the similar practice; therefore, choosing a firm in another city would be worth the cost in travel expenses.]

    c. Greenblatt & Moscowitz performed Firm C's most recent peer review. [This answer is incorrect. A *reciprocal review* occurs when (1) a firm performs a review of the firm that performed its most recent review or (2) a reviewer serves on a review team carrying out a review of a firm whose personnel participated in the most recent review of that reviewer's firm. Interpretation No. 21-1 of the Peer Review Standards precludes firms from performing reciprocal reviews; therefore, Firm C cannot perform Greenblatt & Moscowitz's review under these circumstances.]

    d. Firm D is a member of the same CPA association as Greenblatt & Moscowitz. [This answer is incorrect. In this scenario, Greenblatt & Moscowitz is having a firm-on-firm review, not an association of CPAs review; therefore, the associational affiliation of Firm D does not matter in this scenario, and there is a better choice for Greenblatt & Moscowitz's review.]

12. Which of the following information should be submitted to the review team captain prior to the review? **(Page 52)**

    a. A complete list of the firm's clients. [This answer is incorrect. A complete list of the firm's *accounting and auditing client engagements* would be necessary, but other clients, such as those from the firm's tax practice, would not have to be included.]

    b. A list of the firm's professional personnel. [This answer is correct. During the planning phase of the system review, the team captain will request information about the firm and its accounting and auditing practice to aid in planning the scope of the review, determining the nature and extent of review procedures, and making a preliminary selection of engagements to review. This background information includes things such as relevant engagement manuals, checklists, etc.; partner resumes and background information; and a list of the firm's professional personnel, showing name, position, and years of experience with the firm and in total.]

    c. Documentation of individual and firm licenses. [This answer is incorrect. Documentation of firm and individual licenses, including for states other than where the firm's main office is located and for states other than where an individual primarily provides services, is part of the additional information that the firm should have ready when the review team arrives at the reviewed firm's office. It is not part of the background information sent to the review team ahead of time.]

    d. Three years of CPE records for firm personnel. [This answer is incorrect. Part of the information that the firm should provide to the review team once the team arrives at the firm's office is documentation of CPE records for all personnel for the three most recent educational years. This information would not be sent to the review team ahead of time.]

13. Which of the following is an action that the reviewed firm can take prior to the review that will help the review run more efficiently? **(Page 56)**

    a. Providing one of the review team members with access to obtain files and do any needed copying or scanning. [This answer is incorrect. To make the review go more efficiently, the reviewed firm should assign one of its administrative staff members to the review team to assist in obtaining files, copying, scanning, etc.]

    b. Taking part in a positive enforcement program. [This answer is incorrect. A number of state boards of accountancy require various forms of quality control reviews in their respective states. These are commonly referred to as *positive enforcement programs*. The Peer Review Standards (PR 100.10) note that compliance with a positive enforcement program does not constitute compliance with the AICPA practice monitoring requirement for peer reviews. Therefore, while participating in such a program may be helpful and/or necessary for the firm, it is not an action specifically taken to help a system review run more efficiently.]

    c. Making hotel accommodations and arranging lunches and dinners for the review team. [This answer is correct. Peer reviewers are often from out of town and have a short period of time to complete the fieldwork; therefore, it is in the best interest of the firm to accommodate the reviewers' work schedules. The review will go much smoother if certain details are taken care of in advance of the review teams arrival, including (1) making hotel accommodations, (2) arranging for transportation to the office, (3) arranging for a comfortable work area with Internet access, and (4) planning lunches and dinners for the team members.]

    d. Providing the review team with information on keeping client information confidential. [This answer is incorrect. The Peer Review Standards state that it is the *firm's* responsibility to ensure that all requirements regarding client confidentiality are satisfied. Therefore, the reviewed firm should not expect the reviewing firm to take on this responsibility.]

14. Typically, what is considered the review's *commencement date*? **(Page 57)**

    a. The date the fieldwork begins. [This answer is correct. A peer review generally commences when the review team begins fieldwork. However, a review can commence earlier in certain conditions.]

    b. The date all review documents are sent to the administering entity. [This answer is incorrect. According to the Peer Review Standards, the date by which all required review documents should be completed and submitted to the administering entity is the *due date*, not the commencement date.]

    c. The date the engagement letter is signed. [This answer is incorrect. Once the review team has been selected and the review dates established, the team captain will send the firm an engagement letter. This letter needs to be carefully read and signed by the managing partner or other designated person. However, this is not typically considered the review commencement date. That occurs later in the process.]

    d. The date the firm provides in-house training to prepare for the review. [This answer is incorrect. As the review date approaches, it may be helpful for firms to conduct in-house training to orient the partners and staff to the review process. However, this date would not be considered the review's commencement date. Commencement would likely occur after any in-house training.]

WHAT OCCURS DURING A SYSTEM REVIEW

Although firms ordinarily consider engagement performance as the most important part of a system of quality control, firms should consider all quality control elements (to the extent they are relevant to their practices) in designing their QC systems. During a system review, all elements of the firm's system of quality control will be reviewed to determine if the firm's system of quality control has been designed in accordance with the quality control standards established by the AICPA under QC 10. The review of the firm's system of quality control culminates in a peer review report that provides the peer review team's opinion on the reviewed firm's QC system, not on specific engagements. In this section, the process that occurs during a system review is discussed.

Planning Procedures

A peer review is comprised of three distinct phases: planning, fieldwork, and post-fieldwork activities. Paragraph 38a of the Peer Review Standards (PR 100.38) lists the following procedures as being performed by the peer review team during the planning stage of a system review:

a. Review the results of the prior peer review.

b. Inquire of the firm about the areas to be included in the written representations.

c. Obtain an understanding of the nature and extent of the firm's accounting and auditing practice.

d. Obtain an understanding of the design of the firm's system of quality control, including an understanding of the monitoring procedures performed since the prior review.

e. Assess peer review risk.

f. Use the knowledge obtained from the prior procedures to select the offices (for a multioffice practice) and the engagements to be reviewed and to determine the nature and extent of the tests to be applied in the functional areas. (The QC elements other than engagement performance are collectively known as *functional areas*.)

Those procedures are discussed in the following paragraphs. The fieldwork and post-fieldwork phases of a peer review are discussed later in this section.

The review team captain requests certain items from the firm prior to the commencement of fieldwork to enable the review team to plan the review. A list of the items commonly asked for by the review team captain was provided earlier in this lesson. Some of those items are discussed in more detail in the following paragraphs, including explanation of how the review team uses the items in planning the review.

Review Results of the Prior Peer Review. Reviewing the results of the most recent peer review assists the review team in the planning of the review. The information generally includes the prior year peer review report; the letter of response, if applicable; and the letter of report acceptance from the administering entity. The team captain also reviews any prior FFC forms that the firm received to determine whether current peer review findings need to be reported as repeat comments. (Prior FFC forms may be obtained from the administering entity if the team captain's firm did not perform the prior peer review.) The team captain uses this information to consider whether the issues discussed in those documents require additional emphasis in the current review. Additionally, the review team will evaluate during the course of the review the actions of the firm in response to the prior report.

Areas to be Included in the Written Representations. Firms are required to provide written representations to describe matters significant to the peer review. During planning, the team captain makes inquiries of the firm regarding the nature of the matters to be included in the written representation. The reviewer considers whether those matters will require additional emphasis during the review. Additional information about the firm representation letter is provided later in this lesson.

Understand the Firm's Accounting and Auditing Practice. The review team obtains an understanding of the firm's accounting and auditing practice sufficient to plan the peer review. Such an understanding includes knowledge about the reviewed firm's organization and philosophy, as well as the composition of its accounting and auditing practice. This understanding is generally obtained through inquiries of firm management and other personnel and by reviewing certain background information submitted by management. Submitting background information about the firm to the reviewers was discussed earlier in this lesson.

Understand the Design of the Firm's System of Quality Control. In addition to understanding the firm's accounting and auditing practice, the review team also obtains an understanding of the firm's QC system with respect to each of the quality control elements of QC 10. The review team uses this information to determine that the firm's QC system has been designed in accordance with QC 10, the system is suitably designed for the size and the nature of the firm's practice, the QC policies and procedures are adequately documented, and the QC procedures have been adequately communicated to firm personnel.

The understanding obtained by the review team should include a working knowledge of the design of the firm's QC policies and procedures and how they identify and mitigate risk of material noncompliance with professional standards. This knowledge is generally obtained through inquiries of appropriate firm management and supervisory personnel, as well as by reviewing the firm's quality control documentation and other background information submitted. Effective for peer reviews commencing on or after January 1, 2017, team captains also complete a new form during the planning phase of the review that is designed to evaluate the firm's quality control policies and procedures and determine if the design of the firm's QC system complies with QC 10. For a sole practitioner with no staff, the reviewer will complete form PRPM 4500. For all other firms, the reviewer will complete form PRPM 4600.

QC 10 requires every firm, regardless of size, to have a documented system of quality control for its accounting and auditing practice. The nature, extent, and formality of a firm's quality control policies and procedures should be appropriately comprehensive and suitably designed depending on 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 accounting and auditing practice, and cost-benefit considerations.

Assess Peer Review Risk. After gaining an understanding of the firm's accounting and auditing practice and its QC system, the review team will assess the peer review risk associated with those areas. According to the Peer Review Standards (PR 100.46), *peer review risk* is the risk that the review team will:

- Fail to identify significant weaknesses in the reviewed firm's system of quality control and/or its lack of compliance with the system.

- Issue an inappropriate opinion on the reviewed firm's system of quality control and/or its compliance with the system.

- Reach an inappropriate decision about the matters to be included in, or excluded from, the report.

Peer review risk consists of the following two components:

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

- 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 QC system.

Inherent and control risk are assessed by the review team in planning the system review. The team captain documents the details of the inherent and control risk assessment thought process, and such documentation is subsequently reviewed by technical reviewers and report acceptance bodies. Those risks may be affected by firm circumstances, such as individual partners being responsible for engagements in numerous specialized industries or the firm having a limited number of engagements that constitute a significant portion of its accounting and auditing practice. External circumstances, such as new professional standards being applied for the first time or adverse economic developments in an industry, also affect inherent and control risk. Additionally, as part of obtaining an understanding of the design of the firm's system of quality control, the review team considers the effectiveness of the firm's monitoring policies and procedures performed since its prior peer review. The results of this consideration have implications to the reviewer's assessment of peer review risk. That is, if the firm's QC monitoring system appears effective, the reviewer may assess a lower level of peer review risk. However, the reviewer would assess a higher level of peer review risk if the firm's QC monitoring system is not operating effectively.

Relationship of Risk to Review Scope. The greater the combined assessed levels of inherent and control risk, the higher the peer review risk. To reduce a high level of peer review risk to an acceptable low level, detection risk needs to be low. Accordingly, a higher scope of review will be performed by the review team. A higher scope equates to a greater number of offices that should be visited or a greater 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. Assessed levels of inherent and control risk may vary between offices and engagements. In that situation, review scope will probably be greater for some offices or types of engagements than for others.

While the review team can generally review fewer offices and/or engagements when the combined assessed levels of inherent and control risk are low, the team is still required to review enough engagements to obtain reasonable assurance that the reviewed firm is complying with its quality control policies and procedures and applicable professional standards, and issuing reports that are appropriate in the circumstances. The peer review team obtains that assurance by reviewing engagements that provide a reasonable cross-section of the firm's accounting and auditing practice.

Select Offices and Engagements to Review. The results of the planning procedures previously discussed culminate in the peer review team's selection of the offices and engagements for review, to reduce peer review risk to an acceptable level. As previously mentioned, the higher the assessed level of peer review risk, the greater the number of offices or engagements that need to be reviewed. Visits to practice offices and the selection of engagements should be sufficient to ensure the review team meets the objectives of a system review. Those objectives were discussed earlier in this lesson.

Selection of Offices. When the review team considers which practice offices to visit, they will place greater emphasis on those offices with higher assessed levels of peer review risk. The Peer Review Standards (PR 100.56) list the following examples of factors that reviewers may consider in assessing peer review risk at the office level:

- The number, size, and geographic distribution of the firm's offices.
- The degree of centralization of accounting and auditing practice control and supervision.
- The review team's evaluation of the firm's monitoring procedures.
- Recently merged or recently opened offices.
- 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.
- Extent of nonaudit services to audit clients.
- Significant clients' fees to a practice office(s) and a partner(s).

In addition to the practice offices visited, the reviewer will visit the firm's executive office, if one is designated as such. Interpretation No. 56-1 (PR 9100.56-1) provides a listing of other examples of factors that reviewers may consider when assessing peer review risk at the office level.

Selection of Engagements for Review. The firm's accounting and auditing engagements subject to review are ordinarily those with periods ended during the year under review, except for financial forecasts or projections and agreed-upon procedures. For forecasts or projections and agreed-upon procedures, the selection for review generally should be those with report dates during the year under review. If the current year's engagement has not been completed and issued and a comparable engagement within the peer review year is unavailable, then the prior year's engagement may be reviewed. In addition, if a more recent equivalent (audit, compilation, etc.)

engagement for the client has been completed and issued, then the review team considers, based on its assessment of peer review risk, whether the more recent engagement should be selected instead.

In selecting engagements for review, reviewers consider the guidelines found in the Peer Review Standards. As discussed above, those guidelines provide that a cross-section of the firm's accounting and auditing practice engagements be selected, with greater emphasis on those engagements with higher assessed levels of peer review risk. Some factors that reviewers consider when assessing peer review risk at the engagement level include:

- Engagement size.
- Personnel (including turnover, use of merged-in personnel, engagement experience, and CPE).
- Industry concentration or diversity.
- Inherent industry risk (ERISA, single audits, broker-dealers, etc.).
- Prior peer review results.
- First time peer review.
- Ratio of audit hours to total A&A hours.
- Firm internal changes, such as a merger, etc.
- Level of service performed.
- Initial engagements.
- Quality control materials used.
- Monitoring policies and results.
- New industry standards.
- Litigation in industry areas.
- Extent of nonaudit services provided to audit clients.
- Significance of client fees to practice office(s) and partner(s).
- Communications from regulatory, monitoring, or enforcement bodies.

Interpretation No. 59-1 (PR 9100.59-1) states that determining a reasonable cross-section of a firm's accounting and auditing practice also includes consideration of industries with a significant public interest, the materiality of accounting and auditing hours, and the number of partners and practice offices. Additionally, reviewers need to consider industries the firm identified in the category of "other audits," if any. Interpretation No. 59-2 (PR 9100.59-2) provides other examples of factors that peer reviewers may consider when assessing peer review risk at the engagement level.

The information provided by the firm prior to the review is used by the team captain to select individual engagements. The number of engagements selected will vary with the size and nature of the firm's accounting and auditing practice and the peer review risk. If the team captain finds that meeting all selection criteria results in an inappropriate number of engagements being selected for a firm, the team captain will consult with the administering entity about the selection of engagements for review. To accomplish the selection objectives without reviewing an inappropriate number of engagements, Interpretation No. 62-1 (PR 9100.62-1) indicates that reviewers should consider the following:

- Whether the firm's significant risk areas have received appropriate coverage.

- Whether the review appropriately weighted reviewing work performed by all or most supervisory personnel.
- Whether adequate consideration has been given to the engagements selected based on a firm-wide peer review risk basis. For example, if two offices are selected for review and each has a large client in the same specialized industry, peer review risk should be considered in determining whether more than one of these engagements should be selected for review.

As mentioned earlier in this lesson, the peer review team will provide to the firm the initial selection of engagements to be reviewed no earlier than three weeks prior to the commencement of peer review fieldwork. The reviewed firm is expected to assemble the required engagement documentation, including completed profile sheets for each engagement selected, before the review team arrives at the practice offices selected for review. After the review team arrives on site, the identity of at least one additional engagement generally in the firm's highest level of service will be selected for review by the review team. The engagement not identified to the firm in advance is often called the *surprise engagement*.

In a system review, the Peer Review Standards require that specific types and/or number of engagements *must* be selected (referred to as *must-select* engagements). Interpretation No. 63-1 (PR 9100.63-1) indicates that at least one of each of the following types of engagements is required to be selected if the firm performs such engagements:

- *Governmental.* At least one engagement performed under *Government Auditing Standards* should be selected if the firm performs any engagements under those standards. If the engagement selected is for an entity that is subject to *Government Auditing Standards* but not subject to the Single Audit Act, and the firm performs engagements of entities subject to the Single Audit Act, at least one such engagement should also be selected for review. The review of this additional engagement must evaluate the compliance audit requirements and may exclude those audit procedures strictly related to the audit of the financial statements.
- *Depository Institutions Subject to FDICIA.* Final regulations implementing the FDIC Improvement Act of 1991 (FDICIA) require federally insured depository institutions with $500 million or more in total assets at the beginning of the fiscal year to be audited. Furthermore, auditors of financial institutions subject to FDICIA are required to have a peer review that includes the review of at least one audit subject to FDICIA. The review of that engagement will also include a review of the financial institution's report on internal control if the financial institution's total assets exceed $1 billion.
- *Employee Benefit Plans.* ERISA audits are considered to have significant public interest and, thus, a higher level of risk associated with them. Accordingly, if a firm performs the audit of one or more ERISA entities, at least one such audit engagement should be selected for peer review.
- *Broker-dealers.* Regulatory and legislative developments have made it clear that there is a significant public interest in, and a higher risk associated with, audits of broker-dealers. As explained below, *carrying* broker-dealers have higher risk than *noncarrying* broker-dealers. Therefore, if a firm performs the audit of one or more carrying broker-dealers, at least one such audit engagement (and the related attestation engagement) must be selected for review. Additionally, it is also expected that if a firm's audits of broker-dealers include only noncarrying broker-dealers, the reviewer should select at least one noncarrying broker dealer engagement (and the related attestation engagement) for review. (Also see discussion of the final SEC broker-dealer rules earlier in this lesson.)
- *Service Organizations.* There is a significant public interest in examinations of service organizations that result in the issuance of a SOC 1 or SOC 2 report. Accordingly, at least one such engagement should be selected by the reviewer if the firm performs such engagements. Generally, a SOC 1 engagement would be selected over a SOC 2 engagement if a firm performs both types of engagements due to the reliance on the report by other auditors. However, reviewers may consider it necessary to select both a SOC 1 and SOC 2 engagement, or may determine that it is appropriate to select a SOC 2 and not select a SOC 1 engagement.

When considering the peer review requirements related to determining a firm's *must-select* engagements, the peer reviewer may need to select more than the one engagement from each of the above types in order to obtain an appropriate risk weighted cross-section. For example, if a reviewed firm conducts several ERISA audits of 401(k) defined contribution plans, as well as several ERISA audits of defined benefit pension plans, it may be necessary for the peer review team to select one of each kind of ERISA audit. Similarly, a HUD audit of a mortgage company is completely different from a HUD audit of a Section 8 housing project. Thus, if a reviewed firm performs both types of HUD audits, it may be necessary for the peer review team to select one of each kind of HUD audit. Additionally, reviewers may select more than one of each of the above *must-select* engagements to attain adequate coverage of all partners in the firm or in response to the peer review risk assessment.

Carrying broker-dealers are those that clear customer transactions, carry customer accounts, or hold custody of customer cash or securities. Thus, this type of broker-dealer is considered to have the highest degree of risk among broker-dealers. Accordingly, if a firm performs an audit of one or more carrying broker-dealers, at least one such engagement must be selected for review. In situations where a firm performs only audits of noncarrying broker-dealers, at least one such engagement should be selected for review by the peer review team. Because the peer reviewer considers the various types of carrying and noncarrying broker-dealer audits performed by the firm and is required to ensure that the unique risks associated with the various types were addressed in the review's risk assessment, it is possible that more than one broker-dealer engagement might be selected for review. In making those engagement selections, peer reviewers are also required to consider the experience of the partners in broker-dealer engagements, the relevant CPE of the partner and staff on the engagement, the size of the broker-dealers' businesses, and communications from regulatory agencies.

Other Engagements. In addition to the engagements listed above, additional selections such as the following are likely to be made to appropriately cover a cross section of the firm's accounting and auditing practice:

- At least one engagement from each industry concentration. (An industry concentration is one where the total accounting and auditing hours in that industry equals or exceeds 10% of the firm's total accounting and auditing hours.)
- At least one audit, review, compilation with full disclosure, compilation with disclosures omitted, and attestation engagement. Additionally, preparation engagements under the SSARS fall within the scope of peer review for firms enrolled in the AICPA Peer Review Program and may be selected for review.
- Engagements from as many different partners and supervisory personnel as practical. (Small firms can expect at least one engagement to be selected from each partner.)

Fieldwork Procedures

After the information has been obtained to plan the peer review and the review team has completed the planning activities that can be performed prior to visiting the firm's office, the fieldwork phase of the peer review will commence. Paragraph 38b of the Peer Review Standards (PR 100.38) lists additional procedures that are performed by the review team, most of which occur during the fieldwork stage of a system review:

a. Review the firm's design and compliance with its system of quality control.

b. Review significant risk areas on selected engagements, including the relevant accounting, audit, and attestation documentation and reporting. (This seems to be an area on which peer reviewers strongly focus. The peer reviewer wants to know if the firm understood the significant risks of the engagement and what procedures it followed to address the identified significant risks, including making necessary modifications to procedures checklists and audit programs.)

c. Conclude on the review of engagements.

d. Reassess the adequacy of the scope of the review based on the results obtained to determine whether additional procedures are necessary.

e. Determine the relative importance of matters.

f. Prepare Matter for Further Consideration (MFC) forms, Disposition of MFC (DMFC) forms, and any related Finding for Further Consideration (FFC) forms, as needed.

g. Aggregate and systemically evaluate the matters.

h. Form a conclusion on the type of review report to issue.

i. Obtain written representations from the reviewed firm.

j. Conduct a closing meeting and/or an exit conference with senior members of the reviewed firm.

These procedures are discussed in the remainder of this section.

Review the Firm's Design and Compliance with its System of Quality Control. Once the planning procedures have been completed, the team captain is ready to develop a general plan for the nature and extent of performing compliance tests of engagements and the other quality control system elements required by QC 10. Performing compliance tests of engagements addresses reviewing the engagement performance element of the firm's system of quality control. The Peer Review Standards refer to the review of all elements of the firm's system of quality control other than engagement performance as *functional area* compliance testing.

The review team performs compliance testing of engagements and functional areas at the firm's practice office(s) visited. Compliance testing includes the following procedures:

- Review accounting and auditing documentation for significant risk areas and the reports for selected engagements to evaluate engagement conformity with professional standards and the firm's relevant QC policies and procedures.

- Interview firm personnel at various levels to assess their understanding of, and compliance with, the firm's QC policies and procedures.

- Review evidential matter to determine whether the firm has complied with its QC policies and procedures for each element of its QC system. This may include evidence since the firm's previous review (not only the year under review).

- Review other evidential matter as needed. This may 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.

Beginning with reviews that commence on or after January 1, 2017, the team captain will complete a new form related to the testing of the firm's compliance with its system of quality control. For a sole practitioner with no personnel, the reviewer will complete PRPM 4550. For all other firms, the reviewer will complete PRPM 4650. Additionally, peer reviewers will be focusing more attention on the functional areas of a firm's QC system.

The "Staff Interview Questionnaire" (PRPM Section 4700) is used by the reviewer to interview firm personnel other than management. The interviews may be conducted in the form of staff interviews or by a focus group made up of representatives of the firm's staff. These interviews enable the reviewer to determine the extent to which personnel at varying levels of staff responsibility in the firm understand and comply with the QC system. For example, the firm may indicate in its QC document that professional staff are informed of their assignments to engagements by posting a monthly assignments schedule on the staff bulletin board. The reviewer may verify that this procedure is being followed by asking selected staff persons about how and when they are informed of their engagement assignments.

The goal of the review of engagements is to determine whether the firm conducts its accounting and auditing engagements in accordance with professional performance standards and whether the financial statements and related accountants' reports issued by the firm conform with professional presentation, disclosure, and reporting standards. Specifically, the reviewers conclude whether:

- The financial statements were presented in accordance with GAAP or a special purpose framework.

- The firm had a reasonable basis under applicable professional standards for the report issued.

- The report is presented in accordance with professional standards in all material respects.
- The documentation on the engagement supported the report issued.
- The firm complied with its quality control policies and procedures.

Review Significant Risk Areas on Audit Engagements. As mentioned previously, the review of engagements includes a review of the financial statements, accountants' reports, engagement documentation, permanent files, and correspondence; and discussions with professional personnel assigned to the engagement. Audit engagements have areas that generally have higher inherent risk. Such areas include fraud considerations, use of estimates, emerging issues, and assertions that are difficult to audit. Accordingly, the peer review team ensures that it has determined whether the firm has appropriately:

- Identified the significant risk areas on each audit engagement the review team selected.
- Performed the necessary audit procedures related to significant risk areas identified.
- Documented the auditing procedures performed for those significant risk areas.

Engagement Peer Review Checklists. The PRPM (Sections 20,100–21,200) contains standard engagement checklists that are completed by the reviewer for each selected engagement that meets the specific classification of the individual engagement peer review checklists. Additionally, the PRPM includes a GAAP financial reporting and disclosure checklist (Section 22,300) and IFRS financial reporting and disclosure checklists (Section 22,400 and 22,500). The engagement peer review checklists currently available address the following types of engagements:

- General audit.
- General review.
- General compilation.
- General preparation.
- Governmental audit.
- Not-for-profit audit.
- Employee benefit plan audit.
- Prospective financial statements.
- Agreed-upon procedures.
- Review attestation.
- Other attestation.
- Reporting on controls at a service organization—SOC 1 and SOC 2.
- PCAOB audit.

The PRPM (Sections 22,010–22,160) includes supplemental checklists (checklists designed for use as supplements to the checklists listed above). The supplemental checklists are designed to be completed for the following industry type engagements:

- Banks and savings institution audit.
- Construction contractor engagement.
- Common interest realty association engagement.

- Health care organization engagement.
- HUD audit.
- Personal financial statement engagement.
- Single Audit Act/A-133 engagement—Part A and Part B.
- OMB Single Audit engagement (Uniform Guidance)—Part A and Part B.
- *Government Auditing Standards* (2011 Yellow Book) audit.
- *Government Auditing Standards* (2011 Yellow Book) agreed-upon procedures and other attestation engagements.
- Audit of state and local governments participating in defined benefit pension plans under GASB No. 68.
- Broker-dealer audit.

A feature of these engagement checklists is that, in addition to the engagement performance element, they include questions about certain other QC elements—relevant ethical requirements, human resources, and acceptance and continuance of client relationships and specific engagements. The engagement performance element is unique in that it interfaces with other elements of quality control. On the surface, testing these elements during the engagement peer reviews may appear to be excessive because the review team would have already tested these elements individually. In reality, however, it makes sense to consider these other elements at the engagement level, since many QC procedures related to these functional areas are triggered by events or circumstances that arise during the course of the engagement. For example, the firm's QC system may specify the circumstances that require a consultation to be performed. A logical way to test compliance with this procedure is to have the reviewer determine, during the course of the engagement peer review, whether any such matters occurred on that engagement and, if so, whether they were appropriately identified and resolved by the engagement personnel through consultation procedures. For reviews commencing on or after January 1, 2017, peer reviewers will be devoting more attention to these other QC elements.

Conclude on the Review of Engagements. The review team forms a conclusion on each engagement reviewed by documenting whether anything came to its attention that caused it to believe that the engagement was not performed and/or reported on in conformity with applicable professional standards in all material respects. The team captain is required to promptly inform the firm on an MFC form when an engagement is not performed and/or reported on in conformity with applicable professional standards. (The MFC form is discussed later in this lesson.) Additionally, the team captain reminds the firm of its obligation under professional standards to take appropriate actions as addressed in AU-C 560, *Subsequent Events and Subsequently Discovered Facts*, or the SSARS, as applicable, or, if the firm's work does not support the report issued, as addressed in AU-C 585, *Consideration of Omitted Procedures After the Report Date*.

When an engagement is not performed and/or reported on in conformity with applicable professional standards, it is the responsibility of the reviewed firm to investigate the issue questioned by the review team and determine what timely action, if any, should be taken, including actions to prevent unwarranted continued reliance on its previously issued reports. The reviewed firm should then notify the team captain of the results of its investigation and document on the MFC form prepared by the reviewer the actions planned or taken or the firm's reasons for concluding that no action is required. If the severity of the nonconforming engagement results in more than an MFC, the firm would document on the FFC or its letter of response how it will remediate the nonconforming engagement.

If the firm has taken action, the review team should review documentation of such actions (for example, the reissued report and financial statements or letter recalling previously issued reports) and consider whether the action is appropriate. If the firm has not taken action, the review team should consider whether the firm's planned actions are appropriate.

It is not the purview of peer reviewers or administering entities to instruct reviewed firms to perform omitted procedures, recall accounting or auditing reports to have them reissued, or to revise previously issued financial statements. Those are decisions for the firm and its client to make, and more emphasis is now put on the firm to evaluate and determine the appropriate corrective actions when nonconforming engagements are identified during peer review. The administering entity's peer review committee has the responsibility to evaluate whether the firm's actions are appropriate to address any nonconforming engagements. The firm's actions may affect other corrective actions or implementation plans the administering entity's peer review committee may impose.

Reassess the Adequacy of the Scope of the Review. If the review team concludes that there was a failure by the firm to appropriately apply professional standards in all material respects on one or more of the reviewed engagements, the team will consider if additional peer review procedures are warranted. If additional procedures are considered necessary, those procedures may include an expansion of scope to review all or relevant portions of one or more additional engagements or aspects of functional areas. The review team performs additional procedures to determine whether the failure noted is indicative of a pattern of such failures, whether it represents a significant deficiency in the design of the firm's quality control system, or both.

Determine the Relative Importance of Matters. During the planning and/or fieldwork phases of the system review, the review team may uncover situations that indicate the reviewed firm's QC system is not designed appropriately or the system is not being complied with. To assist in aggregating and evaluating the peer review results, conclude on them, and determine the nature of the peer review report to issue, the review team classifies and documents such situations using the following terminology and forms:

a. A *matter* is identified through the peer reviewers' evaluation of the design of the reviewed firm's system of quality control and/or tests of compliance with it. They are often represented as "No" answers to questions in a peer review questionnaire that warrants further consideration. A matter is documented on a Matter for Further Consideration (MFC) form.

b. A *finding* is one or more related *matters* such that there is more than a remote possibility that the reviewed firm would not perform and/or report in conformity with professional standards. A finding that does not rise to a higher level of exception is documented on a Finding for Further Consideration (FFC) form. Firms may have situations that are determined to be findings by the review team and still receive a report rating of *pass*.

c. One or more *findings* may become a *deficiency* if the peer reviewer concludes it could create a situation in which the firm would not have reasonable assurance of performing and/or reporting in conformity with applicable professional standards in one or more important respects. A deficiency generally will not get elevated to the level of a *significant deficiency* (as explained in item d below) if the reviewer concludes that, except for the deficiency (or deficiencies), the reviewed firm has reasonable assurance of conforming with professional standards in all material respects. Deficiencies result in a report with a rating of *pass with deficiencies.*

d. One or more *deficiencies* become a *significant deficiency* if the reviewer concludes the situation results in not providing the reviewed firm with reasonable assurance of performing and/or reporting in conformity with applicable professional standards in all material respects. Although the difference between a *deficiency* and a *significant deficiency* may seem slight, it becomes a matter of pervasiveness and the number of deficiencies identified. If the deficiencies reach the level where the peer reviewer determines that reasonable assurance does not exist that the firm is performing and/or reporting in conformity with applicable professional standards in all materials respects, then the deficiencies become significant deficiencies. Significant deficiencies result in a report with a rating of *fail.*

Prepare MFC, DMFC, and FFC Forms. Peer reviewers use three forms (MFCs, DMFCs, and FFCs) to document their identification and evaluation of peer review matters, as further explained in the following paragraphs.

<u>MFC.</u> As previously mentioned, a matter is documented by the peer review team on an MFC form. In documenting a matter, the reviewer indicates whether the matter relates to the QC program questionnaire or whether it relates to the engagement questionnaire, and provides a description of the matter, including the underlying cause, when possible. Additionally, the reviewer will indicate whether the matter is one of design or compliance (further discussed later in this lesson). The MFC form is completed in PRIMA by the reviewer and the reviewed firm also provides its response to the MFC in PRIMA.

There are literally hundreds of situations that a reviewer could identify during review that could result in the completion of an MFC. A few examples of general types of situations that reviewers normally write up MFCs for include:

- The firm's quality control policies and procedures in a particular area were not designed in such a manner to provide the firm with reasonable assurance of conforming with professional standards.
- The financial statements were not presented in accordance with GAAP or a special purpose framework in all material respects.
- The firm did not have a reasonable basis under professional standards to issue the report.
- Missing disclosures in the financial statements, but the missing disclosures do not cause the financial statements to be misleading.
- The firm failed to comply with certain of its functional area QC policies and procedures (even though it did conform with professional engagement standards).
- Failure to report on supplementary information included with the financial statements.

The peer review team investigates each matter further before determining whether it should be elevated to a finding, deficiency, or significant deficiency. The reviewed firm performs its own investigation of MFCs and prepares a response describing its position on each one. In many cases, the firm will agree with the review team's findings and the firm's agreement is indicated on the MFC form in PRIMA. If the firm disagrees with the MFC, the firm's response should clearly state the reasons for its position, along with any supporting information or documentation. (Procedures when there are disagreements between a reviewed firm and the reviewer about accounting, auditing, or peer review standards are discussed later in this lesson.)

The following ought to be considered by the firm when responding to MFCs:

- The reviewer's description of the matter should include a description of the finding. At a minimum, this explanation should include one of the following:
    - A description of a professional standard, including the standard's reference, not followed.
    - A description of a firm QC procedure not followed.
    - A description of the omitted documentation.
    - A description of a firm QC policy or procedure that is inadequate.

  If the reviewer does not provide this information, the firm may ask that the MFC be revised to include the information.
- Before agreeing with the reviewer's description of the matter, ensure that the description is specific and complete. It is not to the firm's benefit to agree with vague descriptions such as "The workpapers do not adequately document analytical review." The description should be specific as to what analytical review procedure was not documented.
- If the firm disagrees with the peer reviewer's description of the matter, the reasons for the disagreement need to be described. Such descriptions might include such things as:
    - Why the firm believes the reviewer's explanation of the facts are in error (or are incomplete).
    - Why the firm believes the professional standards support its position (quote the standard).
    - Why the firm disagrees with assertions by the reviewer that the firm has not complied with its QC procedures or that documentation of a matter is not adequate.
- If the firm believes the issue is not material, it can verify the immateriality with actual amounts.

Another important consideration for a firm when responding to MFCs relates to the identification of a matter that the firm believes is an isolated occurrence. If the firm believes the incident is isolated, showing the reviewer additional engagement instances where the standards were properly followed (and thus the matter did not occur), validates the firm's belief. Thus, if the firm can show the reviewer instances where the same issue was handled appropriately, even though the reviewer found one occasion where it was not, the outcome of the review could be influenced. It is important to note, however, that if the reviewer identifies a matter and the firm has no other engagements with the same situation, then the incident cannot be considered isolated. (Isolated matters are discussed further later in this lesson.)

In some cases, the firm's response will convince the peer reviewer that the matter was invalid or insignificant, in which case the MFC is cleared. When different firm personnel are involved in preparing responses to MFCs, there is a danger that those individuals will arrive at different conclusions on similar issues. Therefore, the managing partner, QC director, or other designated person needs to closely supervise the firm's investigation of all MFCs (as well as any discussions with the reviewers) and all responses before they are submitted to the review team to ensure that the firm's conclusions are technically accurate and consistent. It is a best practice for firms to retain copies of MFCs for future reference.

DMFC. To document the disposition of all MFCs, the team captain completes a Disposition of MFC (DMFC) form in PRIMA. All MFCs on the DMFC form will include an indication after each as to whether it was cleared, discussed with the firm during the closing meeting or exit conference, included on an FFC form, or included as a deficiency or significant deficiency in the peer review report.

FFC. When a matter gets elevated to a finding, it is documented on an FFC form in PRIMA even if it does not get elevated further. As mentioned earlier in this discussion, a *finding* is one or more related matters that the peer reviewer believes results in more than a remote possibility that the reviewed firm would not perform and/or report in conformity with professional standards. The FFC is a standalone document that includes the description of the finding; the systemic cause of the finding, if known; and the reviewed firm's response regarding actions planned or taken and the timing of those actions, including who in the firm will be responsible for the actions planned or taken.

Both MFC and FFC forms are subject to review and oversight by the administering entity. FFC forms will be retained by the administering entity in the administrative files until the completion of the next peer review and they will be considered during the performance of the next peer review. The firm's responses on those matters are still important as the report acceptance body will take those responses into account in the evaluation of the findings and the consideration of the implementation plan required, if any.

Matter Elevated Higher Than a Finding. When a matter is elevated higher than a finding, that is, to a deficiency or significant deficiency, then the reviewer communicates it in the report itself. The firm should respond by submitting a letter of response providing the actions it plans to take (including the timing of such actions), or has already taken. The firm's response in this situation is further discussed later in this lesson.

Electronic Data Collection. MFC and FFC information is prepared electronically by the peer review team using the PRIMA online system. The reviewed firm also responds to MFCs and FFCs using the PRIMA system. The PR Board is using the electronic collection of MFC and FFC form information to accumulate data for the purpose of developing peer review training and other materials to improve engagement quality.

Aggregate and Evaluate Review Matters. To conclude on the results of a peer review, the peer review team aggregates the matters identified during the review and determines 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 considers the relative importance to the firm's system of quality control as a whole and their nature, systemic causes, pattern, and pervasiveness to determine the affect on the peer review report (that is, to determine whether the aggregation of the matters noted are findings, and whether one or more findings results in a deficiency or significant deficiency.

A *systemic cause* is a weakness in the firm's system of quality control that allows a matter to occur and remain undetected. The proper determination of the systemic cause is essential in order for the firm to identify the appropriate remediation of the firm's QC system. The team captain, in collaboration with the firm, determines the systemic cause of the matters identified.

Each matter identified on an MFC is classified as either a *design* or a *compliance* matter. A *design* matter means that the firm's system of quality control is missing a necessary QC policy or procedure or the firm's quality control policies and procedures, even if fully complied with, would not provide the firm with reasonable assurance of conforming with professional standards. A *compliance* matter occurs when the reviewed firm does not comply with one of its prescribed policies or procedures, even if it did conform with professional standards and no engagement deficiencies resulted from the noncompliance. As the review team considers design and compliance matters identified, the matters will be evaluated in the context of the firm's size, organizational structure, and the nature of its practice.

In evaluating situations where the firm failed to perform and/or report in conformity with applicable professional standards in all material respects, the peer review team initially determines the systemic cause of the failure. Interpretation No. 83-1 (PR 9100.83-1) indicates that, in the performance of a system review, reviewers should avoid considering the type of review report to issue until the systemic cause of the matter is identified. Examples of causes for failures that might be systemic and might affect the type of peer review report issued include the following:

- The failure related to a specialized industry practice, and the firm had no experience in that industry and made no attempt to acquire training or to obtain consultation and assistance.
- The failure related to an issue addressed 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.
- The failure should have been detected if the firm's quality control policies and procedures had been followed.

If the failure is determined to be the result of an isolated matter, the reviewer would not consider the failure to be systemic in nature. As discussed above, isolated matters occur when there is an incident (or limited incidents) of noncompliance with professional standards or the firm's system of quality control, but the same professional standards or QC system policies and procedures were complied with on other engagements or functional areas reviewed. To determine whether a situation is isolated, the reviewer may expand the scope of engagements or functional areas reviewed. While isolated situations ordinarily would not be included in the peer review report (that is, not elevated to the level of deficiency or significant deficiency), the effect of the failure to the firm's system of quality control as a whole is evaluated in conjunction with the review team's other matters before making a final determination.

The review team will consider the pattern and pervasiveness of matters identified and their implications for compliance with the firm's system of quality control, in addition to their nature, systemic causes, and relative importance in the specific circumstances in which they were observed. In some cases, the design of the firm's system of quality control may be deficient (that is, a *design* matter). In other cases, there may be a pattern of noncompliance with quality control policies or procedures (that is, a *compliance* matter). Either of those situations increases the possibility that the firm might not perform and/or report in conformity with applicable professional standards in all material respects. Alternatively, the types of matters identified may be unrelated, not individually significant, and not directly traceable to a design or a compliance situation. That may lead the reviewer to conclude that the matters were isolated cases and should not result in a peer review report with a rating of other than *pass*.

Form Conclusions on the Type of Report to Issue. As previously mentioned in this section, determining the type of peer review report to issue requires reviewers to consider 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. Further discussion on reporting appears later in this lesson.

Peer Review Rating of *Pass*. A report with a peer review rating of *pass* is issued when the team captain concludes that the firm's system of quality control has been suitably designed and complied with such that it provides the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Firms will receive a peer review rating of *pass* when the review team does not identify matters during their review that get raised to the level of deficiencies or significant deficiencies.

Peer Review Rating of *Pass with Deficiencies*. When the team captain concludes that the firm's system of quality control has been suitably designed and complied with such that it provides 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, a report with a peer review rating of *pass with deficiencies* will be issued. The deficiencies will be described in the report.

Peer Review Rating of *Fail*. When the review team has identified significant deficiencies in the firm's system of quality control either from a design or a compliance perspective such that the firm is not provided with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects, a report with a peer review rating of *fail* will be issued.

Obtain Firm Representations. The firm undergoing peer review is required to provide a written representation letter, addressed to the team captain, that indicates the following, as applicable:

- Affirm compliance with rules and regulations by—
  - Acknowledging responsibility for complying with the rules and regulations of state boards of accountancy and other regulations.
  - Stating that the firm is not aware of any situations where it or its personnel have not complied with rules and regulations for the year under review, including applicable firm and individual licensing requirements in each state in which the firm practices.
  - Summarizing information about known situations of noncompliance, if they exist, including how the firm has or is addressing and rectifying the situations of noncompliance. The firm also affirms that it knows of no other situations of noncompliance.
- Affirm the completeness of the engagement listing by—
  - Stating that the firm provided the reviewer with an engagement listing of all engagements for the year under review (whether issued or not), and that the engagement listing includes, but is not limited to, all engagements performed under Government Auditing Standards, including compliance audits under the Single Audit Act; audits of employee benefit plans; audits performed under FDICIA; audits of broker-dealers; and examinations of service organizations (both SOC 1 and SOC 2), as applicable.
  - Stating that the peer reviewer selected and reviewed at least one of each type of must-select engagement (as listed in the previous bullet and discussed earlier in this lesson that the firm performed during the period covered by the peer review.
  - Acknowledging that failure to provide a complete listing of engagements performed during the year under review could be deemed as a failure to cooperate and result in termination from the Peer Review Program, as well as an investigation of a possible violation by the appropriate regulatory, monitoring, and enforcement body.
- Affirm remediation of nonconforming engagements, if any, by confirming that the firm will remediate nonconforming engagements as stated by the firm on the MFC or FFC forms, or Letter of Response, as applicable.
- Affirm communications from regulatory, monitoring, or enforcement bodies by—
  - Stating that the firm has discussed significant issues from reports and communications from regulatory, monitoring, and enforcement bodies with the team captain, if any.
  - Stating that the firm has provided to the team captain any relevant information received within three years preceding the current peer review year end about those significant issues from regulatory, monitoring, and enforcement bodies.
  - Confirming that either (1) the firm is unaware of any known restrictions or limitations on the firm's (or its personnel's) ability to practice public accounting by regulatory, monitoring, or enforcement bodies

within three years preceding the current peer review year end, or (2) the firm is aware of such restrictions or limitations and has included a summary of them and their effect 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.

- Affirm appropriate use of quality control materials (QCM) by—
  - Stating that the firm understands the intended uses and limitations of the QCM it has developed or adopted.
  - Stating that the firm has tailored and augmented its QCM as necessary so that the QCM provides guidance that is sufficient to assist the firm in conforming with the professional standards that apply to its accounting and auditing practice.
- Affirm other representations, if any, by including any additional representations requested by the team captain based on the circumstances and nature of the review.

The firm is not prohibited from making additional representations, and the firm may tailor the representation letter as long as the above required representations are included. Additionally, Interpretation No. 208-1-1 (PR 9100.208-1-1) indicates that, if during the course of the review, the peer reviewer identifies something that causes him or her to believe the reviewed firm is providing contradictory or questionable information, the reviewer should investigate the matter further and may consider having the firm include the matter in the representation letter.

The representation letter should be dated the same date as the peer review report and should be signed by those members of firm management whom the team captain believes are responsible for the matters addressed by the representations and the firm's system of quality control. Often that individual will be the managing partner and/or the quality control director. A signature in the name of the firm is not appropriate for the firm representation letter.

Failure to provide a representation letter or to provide required representations constitutes a failure to cooperate and the firm would be subject to procedures that could result in the firm's enrollment in the program being terminated. The language of the representation letter has been revised effective for peer reviews commencing on or after January 1, 2017. The Peer Review Standards, Appendix B (PR 100.208), includes illustrations of two representation letters: one of a representation letter that has no significant matters to report, and the other of a representation letter that has been tailored to report on significant matters.

Conduct Exit Conference.

During the closing meeting, the team captain communicates his or her conclusions with senior members of the firm by discussing the following:

- The preliminary review results, including any matters, findings, deficiencies, or significant deficiencies, and the type of report expected to be issued.
- The firm's requirement to respond to any MFC forms, FFC forms, or deficiencies or significant deficiencies to be included in the review report.
- Other suggestions and observations for the firm to consider.

If nonconforming engagements were identified during the review, the closing meeting is also the time that the firm should determine what action needs to be taken to address the nonconforming engagements and the timing of the firm's action. During the course of the review and before the closing meeting, the team captain should have already discussed any matters, findings, deficiencies, and significant deficiencies identified with members of the firm. Accordingly, the firm should have an idea of the level of review report that will be received prior to the closing meeting. That is, neither the closing meeting, nor the exit conference, is the appropriate time or place for the firm to *first* learn that the reviewer intends to issue a *pass with deficiency* or *fail* report, or to hear of unresolved accounting and auditing issues.

The closing meeting is also an appropriate venue for the review team to provide suggestions to the firm that will not affect the report, FFC form(s), or MFC form(s). As mentioned earlier in this lesson, such a discussion between the firm and the reviewer at the conclusion of the peer review is one of the benefits firms can experience in undergoing a peer review. Suggestions include specific steps the firm could take to improve its practice or increase its efficiency. The reviewer may also discuss implications to the firm of upcoming changes in professional standards.

Holding a separate closing meeting provides the firm with the time needed to determine appropriate responses to the items discussed by the review team during the closing meeting, and to provide the team captain with sufficient time to assess the firm's responses prior to the report date and exit conference date. If such steps have already been taken by the firm and the team captain prior to holding a closing meeting, or the steps are unnecessary, the closing meeting and exit conference may be combined. For many peer reviews, the closing meeting and the exit conference are likely to occur at the same time. In the situation where there is uncertainty about the report to be issued or the deficiencies or significant deficiencies to be included in the report, the exit conference is usually postponed.

During the exit conference, the team captain discusses the following:

- The results of the peer review, including any changes to the information that was communicated during the closing meeting after consideration of the firm's responses.

- The potential implications of the report acceptance process by the administering entity that require the firm to develop corrective action on the deficiencies and significant deficiencies or complete an implementation plan to address the findings noted in the FFC form(s), if applicable.

- The implications on the acceptance and completion of the peer review and the firm's enrollment in the AICPA Peer Review Program should the firm not complete corrective actions or the implementation plan.

- Peer review noncooperation implications of consecutive non- pass report ratings, if applicable.

<u>Who Attends the Closing Meeting and Exit Conference?</u> The team captain ordinarily to attends the closing meeting (or the combined closing meeting/exit conference) in person unless the system review was performed at a location other than the reviewed firm's office. On occasion, representatives of the administering entity, the PR Board, AICPA staff, or other PR Board-authorized organizations with oversight responsibility may also attend. If those entities do not attend the exit conference, they will need to be informed of its date to monitor the other following critical dates that are dependent on the exit conference date. The firm is ordinarily represented by senior members of management, such as the managing partner, the quality control director, and/or other appropriate senior partners. If the meeting space allows, some firms consider it beneficial to have managers and/or supervisors in attendance.

When the closing meeting and exit conference are separate events, the closing meeting is generally held at least 30 days prior to the firm's due date. The separate exit conference may be held via teleconference after the firm has responded to any matters, findings, deficiencies, or significant deficiencies, and the team captain has assessed those responses.

<u>What Happens After the Exit Conference?</u> Subsequent to the exit conference, peer reviewers furnish the reviewed firm with a written report, and provide comments to the reviewed firm on its response to the report, if applicable. As previously mentioned, the firm may be required to take corrective action relating to any deficiencies and significant deficiencies identified during the review or complete an implementation plan to address any findings noted in FFC form(s). Additionally, the review must be accepted by the administering entity peer review committee. Those activities are discussed further later in this lesson.

System Reviews at a Location Other Than the Reviewed Firm's Office

Interpretation No. 8-1 of the Peer Review Standards (PR 9011.8-1) states that system reviews should be performed at the reviewed firm's office if reasonably possible. However, some situations make an on-site peer review cost prohibitive or extremely difficult to arrange, or both. In those situations, if the peer reviewer and the firm both agree that the review can be appropriately and efficiently performed at a location other than the reviewed firm's office, then the reviewer can request the administering entity's approval to do so. Such a request is to be made prior to the start of fieldwork, and the firm and reviewer may need to respond to inquiries from the administering entity about various factors that could affect the administering entity's determination. Most administering entities have adopted a specific form to be completed for the request to conduct a system review at a location other than the firm's office. Such factors include, but are not limited to:

- The availability of peer reviewers qualified to review the firm. Consideration of this factor may include the availability of reviewers having appropriate industry and levels of service experience, being independent of the firm, and being reasonably accessible to the firm.

- Consideration of whether the review conducted at the reviewer's office or another agreed-upon location can still achieve the objectives of a system review.

- Consideration of whether the same review results would be achieved by performing the review at a location other than the reviewed firm's office, as would be achieved if the review was performed at the firm's office.

- The size of the reviewed firm, including the number of personnel and where they perform their work. (For example, work is solely performed at client offices because the firm does not have its own office.)

- The number of engagements covered by the auditing standards, *Government Auditing Standards*, or examinations under the SSAEs, or audits performed pursuant to the standards of the PCAOB.

- The ability of the firm and the peer reviewer to hold effective meetings by telephone to discuss the firm's responses to the peer reviewer's questionnaires, engagement review results, conclusions of the review, and any recommended implementation plans or corrective actions.

- The prior peer review results of the firm, including whether the firm received a report with a peer review rating of *pass with deficiencies* or *fail* on its last system or engagement review, or if it is the firm's first system review.

- The firm's ability to send the materials outlined below to the reviewer prior to the review.

Such reviews may provide an opportunity for firms to reduce the cost of their peer review by not having to incur travel costs. However, cost reduction is not a factor that will be considered by the administering entity in its determination of whether to allow the review to be performed away from the firm's office. Additionally, all review documentation required by the Peer Review Standards and the peer reviewer to be reviewed during a system review (which is an extensive list of documents) will need to be sent to the peer reviewer. This may entail making copies of such documentation since most firms are uncomfortable sending their original engagement documentation off-site. If the firm operates using a paperless engagement approach, the firm and peer reviewer need to determine how the reviewer will be able to review engagement documentation. The reviewer and firm may have the exit conference either in person or by telephone. (In other words, a face-to-face meeting is not required between the reviewer and the firm at the conclusion of the review.)

A system review performed at another location other than the reviewed firm's office achieves the objective of a system review and is described as such in the peer review report. It includes all the procedures that are performed in a system review performed at the firm's office, except that the majority of the work is conducted at the reviewer's office.

In addition to the background information listed earlier in this lesson, the reviewed firm is required to send the following information to the reviewer:

- All documentation related to the resolution of independence questions (a) identified during the year under review with respect to any audit or accounting client or (b) related to any of the audit or accounting clients selected for review, no matter when the question was identified, if the matter still exists during the review period.

- The most recent independence confirmations received from other firms of CPAs engaged to perform segments of engagements on which the firm acted as principal auditor or accountant.

- The most recent representations received from all professional staff concerning their conformity with applicable independence requirements.

- A written representation letter dated the same date as the peer review report.

- Documentation, if any, of consultations with outside parties during the year under review in connection with audit or accounting services provided to any client.

- A list of relevant technical publications used as research materials, as referred to in the questions of quality control policies and procedures questionnaire.

- A list of audit and accounting materials, if any, identified in response to the questions in the "Engagement Performance" section of the quality control policies and procedures questionnaire.

- CPE records sufficient to demonstrate compliance by the CPAs in the firm with state, AICPA, and other regulatory CPE requirements.

- The relevant accounting and auditing documentation and reports on the engagements selected for review.

- Documentation of the firm's monitoring results for each year since the last peer review or enrollment in the program.

- Any other evidential matter requested by the reviewer.

In the event that matters are noted during the review of engagements, the scope of the review may have to be expanded before the review can be concluded. Such a situation will generally require selection of additional engagements, which will entail receipt by the peer reviewer of additional engagement documentation.

Reducing the Cost of the Review

Peer reviews performed in an efficient and thoughtful manner make the review process less stressful, minimize the cost of the review, and maximize benefits to the reviewed firm. The following are some examples of how firms can minimize the costs of their reviews:

- Adopt a cost-effective QC system and be sure to comply with it. Do not burden the system with unnecessary policies and procedures.

- Perform a thorough annual inspection/review, even in the year of the review. Although not required, an inspection/review in the year of the review identifies potential problems and resolutions before the review. It is much simpler and less expensive for the firm to come up with a solution for a problem and have the solution implemented before the review is conducted.

- Designate a partner to coordinate the review as discussed earlier in this lesson. That partner needs to have a solid technical background and be intimately familiar with the firm's QC system and how the firm operates.

- Schedule the review during the slowest engagement demand time of the year, if possible.

- Provide the requested background information in a timely manner no later than the date requested by the team captain. This allows the team captain to properly plan the review, and a well-planned review is generally a more efficient review. In fact, it is not uncommon for peer reviewers to specify in their engagement letters that the cost estimate provided the firm is based on the assumption that all information requested of the firm, will be timely, complete, and accurate.

- Be sure the estimated accounting and auditing (A&A) hours include only those hours—not tax, consulting, bookkeeping, other nonattest services, or administrative time. Inflated A&A hours may result in inflated review fees.

- If the firm performs a significant amount of interim financial statement work (such as compiling monthly or quarterly financial statements), consider segregating the estimated A&A hours between interim and year end work (even if the peer reviewer does not request the segregation). Interim engagements are usually subject to a lower selection percentage.

- Summarize the A&A hours by industry and service level. While not always requested by reviewers, this will save the reviewer the time normally spent in preparing such a summary. It would be good practice to provide the information in Excel format to enable the reviewer to more easily work with the information or change it as needed.

- Be sure the workpapers and files for engagements selected for review are available and the engagement profile forms are completed before the reviewer arrives on-site. Also, ensure all other information and documentation requested by the reviewer, either before the review begins or after fieldwork commences, are made available as soon as possible. Providing all information to the reviewer as soon as possible helps ensure that the review team incurs little or no idle time while performing the review and, accordingly, may save peer review fees.

- Respond in PRIMA to any MFC forms and FFC forms as soon as practical. (This is not to imply, however, that MFCs should be answered in haste or without proper consideration.)

- Do not let the reviewer impose personal preferences. The firm should be held accountable only for its QC policies and procedures and professional standards. The adoption of unnecessary policies and procedures can be costly in the future.

SELF-STUDY QUIZ

Determine the best answer for each question below. Then check your answers against the correct answers in the following section.

15. Which of the following statements best describes an aspect of undergoing a system review?

    a. A system review report gives an opinion on both engagement performance and the QC system.

    b. System reviews include planning, fieldwork, and post-fieldwork activities.

    c. The engagement performance QC element should be the firm's focus when preparing for a system review.

    d. Each system review is performed on its own merits without consideration of past reviews.

16. Among other things, *peer review risk* means that the review team may do which of the following?

    a. Issue an opinion on the reviewed firm's QC system that is appropriate under the circumstances.

    b. Perform the engagement with a lower level of scope to reduce the risk.

    c. Deliver a peer review report that is not accepted by the administering entity.

    d. Fail to identify significant weaknesses in how the firm complies with its QC system.

17. Which of the following would be considered a *must-select* engagement under the Peer Review Standards?

    a. At least one governmental audit.

    b. One engagement from each industry served.

    c. At least one attestation engagement.

    d. At least one engagement from each partner.

18. What is the correct term for items identified by the peer reviewers that, often, are "no" answers to questions in a peer review questionnaire and warrant further consideration?

    a. Significant deficiency.

    b. Deficiency.

    c. Finding.

    d. Matter.

19. Which of the following could help a CPA firm reduce the cost of its system review?

    a. Using the system review as its annual review in the year that it occurs.

    b. Scheduling the review during the firm's busy season so that the review team sees partners in action.

    c. Separating estimated accounting and auditing hours from hours from other types of engagements.

    d. Responding thoughtfully to the reviewer's personal preferences so they are comfortable performing the review.

SELF-STUDY ANSWERS

This section provides the correct answers to the self-study quiz. If you answered a question incorrectly, reread the appropriate material. **(References are in parentheses.)**

15. Which of the following statements best describes an aspect of undergoing a system review? **(Page 62)**

    a. A system review report gives an opinion on both engagement performance and the QC system. [This answer is incorrect. The review of the firm's QC system culminates in a peer review report that provides the peer review team's opinion on the firm's QC system, *not* on specific engagements.]

    b. System reviews include planning, fieldwork, and post-fieldwork activities. [This answer is correct. A peer review is comprised of three distinct phases: planning, fieldwork, and post-fieldwork activities. The Peer Review Standards discuss activities that fall into each phase.]

    c. The engagement performance QC element should be the firm's focus when preparing for a system review. [This answer is incorrect. Although firms ordinarily consider engagement performance as the most important part of a QC system, firms should consider *all* QC elements (to the extent they are relevant to their practices) in designing their QC system. During a system review, all elements of the firm's QC system will be reviewed to determine if the firm's system of quality control has been designed in accordance with the QC standards established by the AICPA under QC 10.]

    d. Each system review is performed on its own merits without consideration of past reviews. [This answer is incorrect. Reviewing the results of the most recent peer review assists the review team in planning the review. The information generally includes the prior year peer review report; the letter of response, if applicable; and the letter of report acceptance from the administering entity.]

16. Among other things, *peer review risk* means that the review team may do which of the following? **(Page 63)**

    a. Issue an opinion on the reviewed firm's QC system that is appropriate under the circumstances. [This answer is incorrect. According to the Peer Review Standards, one example of peer review risk is that the team might issue an inappropriate opinion on the reviewed firm's system of quality control and/or its compliance with the system.]

    b. Perform the engagement with a lower level of scope to reduce the risk. [This answer is incorrect. The greater the combined assessed levels of inherent and control risk, the higher the peer review risk. To reduce a high level of peer review risk to an acceptable low level, detection risk needs to be low. Accordingly, a higher scope of review will be performed by the review team. A higher scope equates to a greater number of offices that should be visited or a greater number of engagements that should be reviewed, or both.]

    c. Deliver a peer review report that is not accepted by the administering entity. [This answer is incorrect. Per the Peer Review Standards, one of the elements of peer review risk is that the review team will reach an inappropriate decision about the matters to be included in, or excluded from, the report. The administering entity is not factored into this element of risk.]

    d. Fail to identify significant weaknesses in how the firm complies with its QC system. [This answer is correct. After gaining an understanding of the firm's accounting and auditing practice and its QC system, the review team will assess the peer review risk associated with those areas. According to the Peer Review Standards (PR 100.46), peer review risk is, among other things, the risk that the review team will fail to identify significant weaknesses in the reviewed firm's QC system and/or its lack of compliance with the system.]

17. Which of the following would be considered a *must-select* engagement under the Peer Review Standards? **(Page 66)**

    a. At least one governmental audit. [This answer is correct. According to Interpretation No. 63-1, at least one engagement performed under the Yellow Book should be selected if the firm performs any engagements under those standards.]

    b. One engagement from each industry served. [This answer is incorrect. One additional selection that reviewers often make is at least one engagement from each industry concentration (not each industry). However, this is not one of the must-select engagements listed in Interpretation No. 63-1.]

    c. At least one attestation engagement. [This answer is incorrect. Making sure to select at least one audit, review, compilation with full disclosure, compilation with disclosures omitted, and attestation engagement is additional selection criteria often used by the review team. However, none of these engagement types are considered one of the must-select engagements listed in Interpretation No. 63-1.]

    d. At least one engagement from each partner. [This answer is incorrect. Reviewers often select engagements from as many different partners and supervisory personnel as practical. Small firms can expect at least one engagement to be selected from each partner. However, this is an additional consideration when it comes to engagement selection, not one of the rules for must-select engagements outlined in Interpretation No. 63-1.]

18. What is the correct term for items identified by the peer reviewers that, often, are "no" answers to questions in a peer review questionnaire and warrant further consideration? **(Page 71)**

    a. Significant deficiency. [This answer is incorrect. One or more *deficiencies* become a *significant deficiency* if the reviewer concludes the situation results in not providing the reviewed firm with reasonable assurance of performing and/or reporting in conformity with applicable professional standards in all material respects.]

    b. Deficiency. [This answer is incorrect. One or more *findings* may become a *deficiency* if the peer reviewer concludes it could create a situation in which the firm would not have reasonable assurance of performing and/or reporting in conformity with applicable professional standards in one or more important respects.]

    c. Finding. [This answer is incorrect. A *finding* is one or more *matters*, such that there is more than a remote possibility that the reviewed firm would not perform and/or report in conformity with professional standards.]

    d. Matter. [This answer is correct. A *matter* is identified through the peer reviewers' evaluation of the design of the reviewed firm's QC system and/or tests of compliance with it. They are often represented as "no" answers to questions in a peer review questionnaire(s) that warrant further consideration. A matter is documented on a Matter for Further Consideration (MFC) form.]

19. Which of the following could help a CPA firm reduce the cost of its system review? **(Page 79)**

    a. Using the system review as its annual review in the year that it occurs. [This answer is incorrect. Firms can minimize the cost of their reviews by performing a thorough annual inspection/review, even in the year of the review. Although not required, an inspection/review in the year of the system review identifies potential problems and resolutions before the system review. It is much simpler and less expensive for the firm to come up with a solution for a problem and have the solution implemented before the system review is conducted.]

    b. Scheduling the review during the firm's busy season so that the review team sees partners in action. [This answer is incorrect. To minimize the costs of a review, firms should schedule their reviews, if possible, during the time of the year in which their engagement demand is the lowest.]

c. Separating estimated accounting and auditing hours from hours from other types of engagements. [This answer is correct. To minimize the cost of the review, the firm should be sure the estimated accounting and auditing hours include only those hours—not tax, consulting, bookkeeping, other nonattest services, or administrative time. Inflated accounting and auditing hours could result in inflated fees.]

d. Responding thoughtfully to the reviewer's personal preferences so they are comfortable performing the review. [This answer is incorrect. To minimize the cost of the review, the firm should not let the reviewer impose personal preferences.]

POST-FIELDWORK ACTIVITIES

After the fieldwork phase of the system review is complete, the peer reviewer furnishes the reviewed firm with a written report based on the information provided during the closing meeting and/or exit conference, as discussed previously. The firm is generally required to take corrective action on any deficiencies and significant deficiencies identified during the review or complete an implementation plan to address any findings noted in FFC forms. The reviewer provides comments on the reviewed firm's responses to the report. This section discusses those post-fieldwork activities.

Preparation of a Written Report on the Results of the Review

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 brief description of each type of peer review report and the review results that dictate when each report is issued was provided earlier in this lesson. A system review report is generally dated as of the date of the exit conference. A report on a peer review performed by a firm is issued on the letterhead of the firm performing the review. A report on a peer review performed by a review team formed by an association of CPA firms is issued on the letterhead of the team captain's firm. The report is signed in the team captain's firm name. An illustrative system review report with a review rating of *pass* is included in the Peer Review Standards, Appendix C (PR 100.209). An illustrative system review report with a review rating of *pass with deficiencies* is included in the Peer Review Standards, Appendix E (PR 100.211). An illustrative system review report with a review rating of *fail* is included in the Peer Review Standards, Appendix I (PR 100.215).

Contents of System Review Report. The PR Board revised the format and certain language in the system review report effective for reviews commencing on or after January 1, 2017. The changes include, among other things, a revised title and headings for each section of the report. The report continues to include a scope paragraph and an opinion paragraph. If the firm performs any type of engagement that the peer reviewer must select for review pursuant to the Peer Review Standards, another paragraph listing such engagement(s) is included. Additionally, in the event of a scope limitation, another paragraph is added to the report that explains relevant information about the scope limitation. If the reviewed firm receives a report with a rating of other than *pass*, additional information will be included in the report that describes the deficiencies or significant deficiencies that resulted in the less than *pass* report rating.

Although the reviewer drafts the report, it may be beneficial for the reviewed firm to also be familiar with the general guidance for system review reports. The following information, which provides an overview of system review reports, is based upon guidance from the Peer Review Standards (PR 100.96). The written report that results from a system review includes the following:

a. A revised title at the top of the report that reads, "Report on the Firm's System of Quality Control."

b. New headings for each section of the report that include:

    (1) Firm Responsibility.

    (2) Peer Reviewer's Responsibility.

    (3) Required Selections and Considerations (if applicable).

    (4) Deficiency(ies) or Significant Deficiency(ies) Identified in the Firm's System of Quality Control (if applicable).

    (5) Scope Limitation (if applicable).

    (6) Opinion.

c. States that the firm's system of quality control for the accounting and auditing practice was reviewed and includes the year-end covered by the peer review.

d. States that the review was conducted in accordance with the standards established by the PR Board of the AICPA.

e. States that a summary of the nature, objectives, scope, limitations of, and procedures performed in a system review are described in the standards. Includes a URL reference to the AICPA website where those standards are located, and states that the summary includes an explanation of how nonconforming engagements, if any, are evaluated by a peer reviewer to determine a peer review rating.

f. States 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 and for evaluating actions to promptly remediate nonconforming engagements, where appropriate, and remediating weaknesses in its QC system, if any.

g. States that the reviewer's responsibility is to express an opinion on the design of and compliance with that system based on the review.

h. Identifies engagement types required to be selected and indicates whether single or multiple engagements were reviewed, when applicable.

i. States that the peer review considered reviews by regulatory entities as communicated by the firm, if applicable, in determining the nature and scope of the procedures performed.

j. In the event of a scope limitation, includes an additional paragraph before the opinion paragraph that describes the relationship of the excluded engagement(s) or functional areas(s) to the reviewed firm's practice as a whole, the highest level of service and industry concentration for the engagement(s) excluded from potential selection, and the effect of the exclusion on the scope and results of the peer review. Tailors the opinion, as appropriate, to address the scope limitation.

k. Identifies the different peer review ratings that the firm could receive.

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

   (1) Expresses an opinion on whether 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.

   (2) States that the firm has received a peer review rating of *pass*.

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

   (1) Expresses an opinion that, except for the deficiencies 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.

   (2) States that the firm has received a peer review rating of *pass with deficiencies*.

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

   (1) Expresses an opinion that as a result of the significant deficiencies 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.

   (2) States that the firm has received a peer review rating of *fail*.

o. In a report with a peer review rating of *pass with deficiencies* or *fail*:

(1) Includes descriptions of the deficiencies, including reference to the applicable QC standard, the scenario that led to the deficiencies or significant deficiencies, and reference to any nonconforming engagments that resulted.

(2) Identifies for the deficiencies or significant deficiencies included in the report, any that were also made in the report issued on the firm's previous peer review based on the systemic cause of the deficiencies or significant deficiencies.

(3) Identifies the level of service for any deficiencies or significant deficiencies, as well as the applicable industries if deficiencies or significant deficiencies are industry specific.

(4) Identifies must-select industries and practice areas where nonconforming engagements were noted as a result of deficiencies or significant deficiencies.

Scope Limitations. A scope limitation occurs when the peer reviewers are unable to perform one or more review procedures considered necessary and the review team cannot accomplish the objectives of those review procedures through alternative procedures. Scope limitations often occur when firms divest a portion of their practice or sell an office during the peer review year. In the event the reviewed firm has acquired another practice (or a portion thereof) or has divested of a significant portion of its practice during or after its peer review year, the reviewer, the reviewed firm, or both should consult AICPA staff prior to the commencement of the review to consider the appropriate scope of the review or other actions that should be taken. Even though the firm's organizational structure has changed, the review team must be able to assess compliance with the reports issued under the firm name during the year under review or consider reporting a scope limitation. Interpretation No. 5c-1 of the Peer Review Standards (PR 9100.5c-1) provides information about such situations.

Scope limitations also occur when the reviewed firm refuses to allow the workpapers of certain engagements to be reviewed. Such restrictions can be for legitimate reasons, such as when the client refuses to allow the workpapers to be reviewed or when the financial statements of the engagement are the subject of litigation. Merely refusing to allow an engagement to be reviewed does not automatically result in a scope limitation that must be reported, however. The administering entity considers a number of factors, such as the reasons selected engagements are not available for review, the relative size and complexity of the engagement, and whether other engagements can be substituted that cover a similar area of practice and the work of the supervisory personnel who participated in the engagement. The following are some unacceptable reasons for excluding an engagement from the peer review that could result in a scope limitation:

- The engagement workpapers are in a warehouse.
- The firm no longer performs the audit for the client (but the firm still has access to the documentation).
- The firm has discontinued performing audits.
- The engagement was selected during the last peer review.
- The partner on the engagement will be unavailable during the peer review.
- The firm no longer performs engagements in the particular industry.

A firm's refusal to provide the peer review team an engagement, without a valid reason, could become more than a scope limitation. Such behavior could be considered failure to cooperate with the peer review program and result in termination from the program. The Peer Review Standards, Appendix D (PR 100.210) provides an illustration of a report with a peer review rating of *pass* (with a scope limitation) in a system review.

Peer Review Report Rating of *Pass with Deficiencies*. When a firm receives a report with a peer review rating of *pass with deficiencies*, this means the firm's system of quality control is designed and being complied with appropriately by the firm in all material respects, except in certain situations that are explained in detail in the peer review report. The deficiencies alluded to in the report are conditions related to the firm's design of, and compliance with, its system of quality control that created a situation in which the firm had less than reasonable assurance of performing and/or reporting in conformity with applicable professional standards in one or more important respects. Peer reviewers consider the nature, systemic causes, pattern, or pervasiveness, including the relative importance of the deficiencies to the quality control system taken as a whole, when assessing if matters should be elevated to the level of deficiencies. How peer reviewers make that determination was discussed earlier in this lesson.

Peer Review Report Rating of *Fail*. If the peer reviewer has determined that the firm's system of quality control is not suitably designed or being complied with, a firm receives a report with a peer review rating of *fail*. The reviewers determine that a report rating of *fail* is appropriate through identifying matters that arise to the level of significant deficiencies, similar to the process described in the previous paragraph regarding deficiencies.

Significant engagement deficiencies relate to matters that are normally material to understanding the report or important accounting or auditing procedures (and are not isolated situations) specifically, when the reviews of selected engagements reveal that firm personnel have failed to:

- Perform all procedures necessary to conform with professional standards, such as:
  - Preparing an appropriately detailed audit program.
  - Obtaining sufficient competent evidential matter such as management representation letters or, when required, legal letters.
  - Performing required audit procedures, such as observation of inventories, confirmation of receivables, or analytical procedures.
  - Documenting procedures performed to the extent required by professional standards, such as matters covered in the inquiry and analytical review procedures for a SSARS review or the assessment of fraud risk for an audit.
- Reach appropriate conclusions regarding material accounting issues.
- Identify missing or incomplete financial statement disclosures required by GAAP.
- Conform with applicable reporting standards, such as issuing an audit or review report when not independent, or issuing a review report on financial statements when required disclosures are not included in the financial statements.

Consequences of a Peer Review Report Rating of *Pass with Deficiencies* or *Fail*. Firms that initially receive a peer review report with a rating of *pass with deficiencies* or *fail* might keep in mind that required corrective actions relating to the deficiencies or significant deficiencies noted during peer review are intended to help improve the firm's practice. However, it is important that firms take a positive and swift approach to correcting deficiencies identified during peer review so that the firm may receive a review report with a rating of *pass* during the next peer review. As part of the PR Board's initiative to improve practice monitoring, discussed earlier in this lesson, firms that now receive an initial peer review report rating of *pass with deficiencies* or *fail* will now be notified (by certified mail or its equivalent) that, should the firm receive a consecutive peer review report rating of *pass with deficiencies* or *fail*, the firm may be deemed as failing to cooperate. That is, a firm that does not take swift and positive action to correct deficiencies and significant deficiencies could be subject to *termination* of enrollment in the program by a hearing panel of the PR Board if its next peer review also results in a *pass with deficiencies* or *fail* rating. (Termination from the program is discussed later in this lesson.)

Firms may choose to have an accelerated review after they have revised their system of quality control and corrected the deficiencies and significant deficiencies. Many firms are successful in receiving a subsequent "clean" review report after making appropriate changes to their QC policies and procedures. This may be particularly important to firms that are required to submit a copy of their review report with bid proposals or those that are in a public file. (Paragraph 3.106 of *Government Auditing Standards* states that a firm seeking to enter into a contract to perform an audit in accordance with GAS should provide its most recent peer review report to the party contracting for the services when requested. Any subsequent peer review reports received during the period of the contract should also be provided.)

Consequences of Nonconforming Engagements Found during Peer Review. For each nonconforming engagement identified during review, regardless of whether the nonconforming engagement results in a peer review report with deficiencies, the firm has a responsibility to appropriately consider how to remediate the identified nonconforming engagement(s); that is, whether to perform the procedures that were omitted, reissue the accountant's or auditor's report, or have the client revise previously issued financial statements to meet professional standards. (In the context of a peer review, a *nonconforming engagement* is one that is deemed as not performed or reported on in conformity with applicable professional standards in all material respects.)

The firm should provide a written response to the reviewer stating how it intends to address each nonconforming engagement, including its consideration of the continued reliance by third-party users on reports issued or work performed. Additionally, the firm should include a summary of its considerations and conclusions in its response. [Examples of illustrative letters of response for a report with a peer review rating of *pass with deficiencies* and a peer review rating of *fail* can be found in the appendix section of the Peer Review Standards at Appendix F (PR 100.212) and Appendix J (PR 100.216), respectively.] The peer reviewer and the administering entity are required to evaluate whether the firm's response is appropriate, but are prohibited from instructing or requiring the firm to take action on the nonconforming engagement.

Additionally, to address nonconforming engagements for industries with high public interest and subject to regulatory scrutiny, administering entities may require a firm may join either the Employee Benefit Plan Audit Quality Center or Government Audit Quality Center (if the firm is eligible to enroll in the center). The administering entity requires such a corrective action only when it believes that membership in the audit quality center would improve the quality of the firm's system of quality control related to those types of engagements. Joining the appropriate audit quality center is combined with other appropriate corrective actions. (Further information about the audit quality centers was provided earlier in this lesson.)

Effective for peer reviews commencing on or after December 1, 2017, administering entities may allow the AICPA's Single Audit and EBP Certificate Programs to be used as corrective actions for firms in response to nonconforming engagements in the single audit and employee benefit plan practice areas. Allowing identified firm members to pass the relevant certificate program would be used in lieu of completing other required CPE.

Firm Responses in a System Review and Related Team Captain Considerations

If the reviewed firm receives a report with a peer review rating of *pass with deficiencies* or *fail*, it should respond in writing to the deficiencies or significant deficiencies identified in the report. The firm's letter of response should be addressed to the administering entity's peer review committee. However, a draft of the firm's responses should be provided to the team captain before being sent to the administering entity and as soon as practicable to allow the team captain sufficient time to assess the firm's responses prior to the exit conference. The team captain's assessment also provides an opportunity to correct any misunderstandings and allows the reviewer to provide valuable guidance on the wording of the firm's response. The importance of the letter of response is evidenced by the fact that a peer review is not formally accepted by the administering entity until it has considered the firm's response. The reviewed firm also responds to all findings and related recommendations on the FFC form(s) that did not get raised to the level of a deficiency or significant deficiency. Those responses are made on the related FFC form(s) in PRIMA, and the firm should also provide a draft of those. Firms may want to discuss their proposed responses to the team captain prior to the exit conference.

For each finding, deficiency, and significant deficiency identified during the review, the firm should address the following:

- For nonconforming engagements, the firm should describe the actions it has taken or plans to take to remediate (1) the engagements identified on the FFC form or in the report and (2) the findings and deficiencies in the firm's system of quality control.

- For systemic issues unrelated to nonconforming engagements, the firm should describe the actions it has taken or plans to take to remediate the findings and deficiencies in the firm's system of quality control.

- The timing of all remediation actions.

If the reviewed firm receives a report with a peer review rating of *pass*, a letter of response is not applicable, and the reviewed firm does not submit a copy of the report to the administering entity because the team captain will have already done so.

Firms that audit entities subject to the FDIC Improvement Act of 1991 (FDICIA) are required to file two copies of the review report and letter of response with the FDIC. The filing should be within 15 days after receiving notification that the report has been accepted by the administering entity, or before commencing the firm's next audit under FDICIA.

Interpretation No. 97-1 (PR 9100.97-1) provides additional explanation of the purpose of the firm's responses and what is expected within those responses. Firms are required to provide letters of response in order to stipulate, in writing, the specific action(s) that the firm will take to correct deficiencies noted by the reviewer and to improve the current system of quality control. A firm should not provide a letter of response that is vague or merely repetitive of the deficiency or significant deficiency in the report because such a response makes it difficult to determine if the firm's planned action will be appropriate to ensure prevention of further instances of the same deficiency or significant deficiency. Nor should the letter of response be used as a vehicle to justify the firm's actions related to the deficiency or significant deficiency. Instead, the letter of response should adequately describe the action(s) the firm has taken or will take and how the action(s) should prevent a recurrence of the deficiency or significant deficiency detailed in the report. Additionally, the action(s) described should be feasible, genuine, and comprehensive.

Repeat Deficiencies, Significant Deficiencies, or Findings

As indicated above, repeat deficiencies or significant deficiencies are identified as such in the report. Interpretation No. 96n-1 (PR 9100.96n-1) further states that the indication of a repeat deficiency or significant deficiency in the current year report should state that the deficiency (or significant deficiency) was noted in the firm's previous peer review. This also applies when the deficiency or significant deficiency noted during the current review was caused by the same system of quality control weakness noted on an MFC and/or an FFC form during the prior review. Under such circumstances, it would still be appropriate to use the wording as previously described. When repeat deficiencies or significant deficiencies have occurred on more than one prior review, the reviewer should state in the current report that the deficiency (or significant deficiency) was noted on previous reviews. (Firms should be aware that failing to correct deficiencies or significant deficiencies is one reason that a firm may be deemed as noncooperative, as discussed later in this lesson.)

If corrective actions were implemented by the firm and the same deficiency or significant deficiency occurs again, the review team, in collaboration with the firm, should determine the weakness in the firm's quality control system that allowed the deficiency or significant deficiency to occur. If the prior corrective actions appear to be effective, then the current deficiency or significant deficiency may be caused by a different weakness in the firm's system of quality control. When the reviewer determines that the systemic cause of the deficiency or significant deficiency is different, then the current year deficiency or significant deficiency would not be a repeat finding.

For example, financial statement disclosure deficiencies caused by a failure to complete a disclosure checklist as required by the firm's quality control document were found to be significant and reported in the previous review report. During the current peer review, financial statement disclosure deficiencies were again noted. It is determined that, while the nature of the omitted disclosures are different from those noted during the previous review, the cause is the same (i.e., the failure to complete the disclosure checklist required by the firm's quality control document). This finding is a repeat finding. If, however, during the current review, the disclosure deficiencies are the same as those reported in the previous review but the disclosure checklist had been completed in each instance, the finding would not be a repeat finding. Even though the problem has not been solved, the reported cause has in fact been corrected. In this instance, the reviewer would identify a different quality control system weakness.

REVIEW ACCEPTANCE

The final step in the review process is the acceptance of the review by the administering entity peer review committee. However, before the peer review committee can accept a peer review, a technical review is performed. Technical reviews are required on all peer reviews. It is not uncommon for issues to arise as part of the technical review, and any such issues need to be resolved between the technical reviewer and the peer reviewer before the peer review can be submitted to the peer review committee. (It is rare for the technical reviewer to directly contact the reviewed firm unless a disagreement exists between the reviewer and the reviewed firm. Disagreements are addressed later in this lesson.) Once the technical review is completed, the review is submitted to the peer review committee for acceptance. If the administering entity peer review committee agrees with the report and letter of response and deems that no further actions are necessary, they will be accepted. In this case, according to Interpretation No. 25-2 of the Peer Review Standards (PR 9100.25.2), the acceptance and completion dates of the peer review are the same. Firms may distribute copies of the review report and letter of response (if applicable) to firm personnel, clients, or others as soon as they have been notified that the report has been accepted. Many firms choose to distribute only the report.

The administering entity peer review committee may require additional corrective actions (such as specific types and amounts of CPE or requiring another CPA to perform reviews of the reports and financial statements issued by the firm) or monitoring activities (such as requiring the firm to submit CPE records or inspection reports, revisits by the team captain, or accelerated reviews) as a condition of its acceptance of the review. In such a case, the firm must agree in writing to perform the corrective action(s) before the report is accepted. Interpretation No. 25-2 (PR 9100.25-2) states that, in this case, the acceptance date is the date the reviewed firm signs a letter from the administering entity agreeing to perform the correction actions, and the completion date is the date the administrative entity decides that all corrective actions have been performed. The administering entity will note the completion date in a final letter to the reviewed firm.

Timetable for Report Acceptance

As previously noted, a team captain has 30 days from the exit conference date or by the firm's peer review due date, whichever date is earlier, to issue the review report(s). In some instances, the reviewer may issue the peer review documents at the end of the exit conference. Upon receipt of the peer review documents, the reviewed firm has 30 days from the date those documents are received from the team captain or by the firm's peer review due date, whichever is earlier, to submit the letter of response, if necessary, to the administering entity. Most administering entities then allow 30 days for the state society's staff (or a designated committee member) to review the documents and related workpapers. Based on those steps, a minimum of at least 90–120 days is often required before a report can be considered for approval by the administering entity peer review committee.

Press Releases

For firms that choose to publicize the results of their peer review, press kits are available from their administering entity. However, some practitioners have questioned whether making the results of a peer review public allows an attorney to successfully subpoena the peer review documents in states that have otherwise enacted legislation making such documentation privileged. Firms may wish to consult an attorney prior to publicizing the results of their review.

Public Availability of Peer Review Results

Reviewed firms that are members of PCPS, the AICPA Governmental Audit Quality Center, or the AICPA Employee Benefit Plan Audit Quality Center must make publicly available the following information about the most recently accepted peer review:

- Peer review report.
- Letter of response, if applicable.

The information is placed in a public file at the AICPA that is accessible through the AICPA's website.

PROCEDURES FOR RESOLVING DISAGREEMENTS

The Peer Review Program recognizes that disagreements among the reviewed firm, the review team, and the administering entity will occasionally occur and has accordingly established guidelines in the Peer Review Standards (PR 100.93), to address those situations. The reviewed firm and the peer reviewer may consult with the administering entity when the disagreement has not been solved and the parties continue to challenge each other on the issue. If the disagreement is not solved by the administering entity's involvement, the disagreeing parties may request a panel of the administering entity's peer review committee to resolve the disagreement. The panel is required to reach a decision that resolves the disagreement. However, a disagreeing party may further request an appeal by writing the PR Board and explaining his or her rationale for requesting a review of the panel's decision. A panel formed by the PR Board will then consider the appeal request and can refer the matter to an ad hoc PR Board committee for review. All decisions made by the ad hoc PR Board committee are final.

In an attempt to resolve the disagreement without elevating it to the administering entity and possibly the PR Board, the disagreeing parties should work diligently to arrive at a resolution to the issue. The parties might begin by consulting with an appropriate authoritative body, such as the FASB about an accounting matter or the administering entity about a peer review matter.

Termination from the Program

As mentioned earlier in this lesson, at the time of enrollment in the AICPA Peer Review Program, one of the responsibilities that a firm accepts is to cooperate with the peer reviewer, administering entity, and the PR Board in all matters related to the peer review. If the PR Board determines that a firm is not cooperating, the firm's enrollment can be dropped, without a hearing, 30 days after the AICPA Peer Review Program notifies the firm by certified mail (or other delivery method that provides proof of receipt) that the firm has failed to do one or more of the following:

a. Timely file the requested information with the administering entity concerning the arrangement or scheduling of the review, prior to the commencement of the review.

b. Effective for peer reviews commencing on or after December 1, 2017, administering entities may allow the AICPA's Single Audit and EBP Certificate Programs to be used as corrective actions for firms in response to nonconforming engagements in the single audit and employee benefit plan practice areas. Allowing identified firm members to pass the relevant certificate program would be used in lieu of completing other required CPE.

c. Timely submit requested information to the reviewer necessary to plan and perform the firm's peer review, prior to the commencement of the review.

d. Have a peer review by the required due date (that is, the date by which all required review documents should be completed and submitted to the administering entity).

e. Accurately represent its accounting and auditing practice, as defined by the Peer Review Standards, after notifying its administering entity that it does not perform engagements that require the firm to have a peer review.

f. Timely pay in full the fees and expenses of the review team formed by an administering entity.

g. Timely pay the fees related to the administration of the program that have been authorized by the governing body of the administering entity and the AICPA.

Additional reasons for a firm being deemed as failing to cooperate are discussed below. Effective May 1, 2016, the PR Board shortened the amount of time it takes for a hearing to occur for firms that are deemed as failing to cooperate. Similarly, the amount of time required before a firm is dropped from the AICPA Peer Review Program was also shortened. Under the revised timeframes, it is possible for a firm to be dropped before its due date.

If a firm's enrollment is dropped for not accurately representing its accounting and auditing practice or subsequently failing to submit a peer review by the required date, the matter will result in an investigation of a possible violation by an appropriate regulatory, monitoring, or enforcement body. Additionally, if a firm's enrollment is dropped for those reasons, re-enrollment in the program will be subject to approval by a hearing panel.

Additionally, a firm is deemed as failing to cooperate by—

- Not responding to inquiries once the review has commenced.
- Withholding information significant to the peer review, for example, but not limited to:
  - Failing to discuss communications received by the reviewed firm relating to allegations or investigations by regulatory, monitoring, or enforcement bodies with regard to the conduct of accounting, auditing, or attestation engagements.
  - Omitting or misrepresenting information related to its accounting and auditing practice, as defined by the Peer Review Standards, including, but not limited to; (a) engagements performed under *Government Auditing Standards*; (b) audits of employee benefit plans; (c) audits performed under FDICIA; (d) audits of broker-dealers; and (e) examinations of service organizations (SOC 1 and SOC 2 engagements).
- Not providing documentation, including but not limited to, the representation letter, quality control documents, engagement working papers, and all aspects of functional areas.
- Not responding to MFCs or FFCs in a timely manner.
- Limiting access to offices, personnel, or other once the review has commenced.
- Not arranging for the exit conference on a timely basis.
- Failing to timely file the report and the response related to its peer review, if applicable.
- Failing to cooperate during oversight.
- Failing to timely acknowledge and complete required corrective actions or implementation plans.

A firm suspected of failing to cooperate, as discussed above, is advised by certified mail (or other delivery method that provides proof of receipt) that the PR Board will appoint a hearing panel to consider whether the firm's enrollment in the program should be terminated. In that situation, the notified firm may not resign until the matter causing the hearing has been resolved. After the hearing is held, an AICPA member firm whose enrollment has been terminated has the right to appeal the panel's decision to the AICPA Joint Trial Board within 30 days of the hearing. A firm that is not an AICPA member firm whose enrollment has been terminated has the right to appeal under fair procedures established by the PR Board within 30 days of the hearing.

A firm is also considered as failing to cooperate when:

- The firm fails to receive a report with a rating of *pass* after it (a) received a peer review report with a rating of *pass with deficiencies* and/or *fail* and (b) received notification via certified mail (or other delivery method that provides proof of receipt) that a consecutive failure to receive a report with a peer review rating of *pass* may be considered a failure to cooperate with the administering entity. Additionally, if the firm fails to correct deficiencies or significant deficiencies after consecutive corrective actions imposed by the committee on the same peer review, the firm may also be considered as failing to cooperate.
- The administering entity determines that a response is not substantive, and the firm does not revise its response or submits additional responses that are not substantive, as determined by the administering entity.
- The firm erroneously provided or omitted information that resulted in a significant change in the planning, performance, or evaluation of results by the peer reviewer or in the peer review report issued. Additionally,

the firm's failure to provide substantive responses to the administering entity during its process of evaluating such a matter may also be deemed as a firm's failure to cooperate.

- The firm fails to promptly notify the administering entity that it is performing a type of engagement(s) or an engagement(s) in an industry it had previously represented that it no longer performed and had no plans to perform in the future; and such representation was made in response to a corrective action or implementation plan, which resulted in the administering entity eliminating the corrective action or implementation plan.

If at any time in the above process the firm acknowledges guilt to the "charges" of being uncooperative, a firm's enrollment in the AICPA Peer Review Program can immediately be terminated, without a hearing. The firm's termination from the AICPA Peer Review Program will be published in such form and manner as the AICPA Council may prescribe. Effective for terminations resulting from hearing panels after January 13, 2016, specific language describing the matters leading to a firm's termination are included in the notice of termination posted on the AICPA's website and in letters provided to state boards of accountancy.

Recall of Peer Review Documents. If a firm either omits or misrepresents information about its accounting and auditing practice that results in a material departure in the firm's most recently accepted peer review, acceptance of the peer review documents will be recalled. (The term *material departure* is defined by the Report Acceptance Body Handbook to be a departure resulting in a peer review that was not properly performed or reported on in all material respects, thus necessitating a significant change in the peer review report. Some circumstances that would generally lead to a material departure result from the need to change the type of peer review, the period covered, or *must-select* engagements, such as audits of employee benefit plans.) In that circumstance, a hearing panel makes the determination of whether the firm's enrollment in the program will be terminated. If the firm's enrollment is not terminated, the firm will be required to have a replacement review within 60 days of the hearing panel's decision. However, if a firm's enrollment is terminated due to omission or misrepresentation as previously described, or for subsequent failure by the firm to submit a replacement review by the due date established by the hearing panel, the matter will result in referral to an appropriate regulatory, monitoring, or enforcement body, and future re-enrollment will be subject to approval by a hearing panel. (Recall of previously issued peer review documents may also occur due to nonqualification or ineligibility by the reviewer to perform the peer review.)

If a firm voluntarily notifies the administering entity about an omission or misrepresentation that resulted in a material departure, the firm will not be subject to a hearing panel. However, the voluntary notification must take place before the AICPA or administering entity learns of the omission or misrepresentation through other means, or before the firm receives notification from another regulatory or monitoring agency. In such a circumstance, acceptance of the peer review documents will be recalled and the firm will be required to submit a replacement review to its administering entity within 90 days after the firm's notification to the administering entity.

When peer review documents are recalled, the reviewed firm is responsible to notify all parties to discontinue reliance on previously distributed peer review documents. This includes, but is not limited to, notification to the state board(s) of accountancy, current or potential clients, regulators, enforcement agencies, insurance carriers, or applicable government agencies. The firm is also responsible for removal of the documents from publicly available sources, such as the firm's website. Peer review documents include the peer review report, acceptance letter, and letter of response (if applicable). As previously mentioned, most states have a practice monitoring requirement in order for CPA firms to maintain a firm license. Accordingly, when peer review documents are recalled, the AICPA staff or administering entity will notify the applicable state boards, which will likely result in a licensing issue for those firms. Additionally, the AICPA staff or administering entity removes peer review documents from information under their control that has been made publicly available.

DOCUMENTATION AND RETENTION

Peer Review Documentation

Peer review documentation includes records of the planning and performance of the work, the procedures performed, and conclusions reached by the peer reviewer. This includes documenting the risk assessment, the understanding of the firm's system of quality control, and tests of compliance (including checklists for the review of engagements and staff interviews). Ordinarily, materials and checklists developed and issued by the PR Board are to be used by reviewers in carrying out their responsibilities under the Peer Review Standards. Failure to complete relevant materials and checklists may create the presumption that the review was not performed in conformity with the Peer Review Standards. Accordingly, if a reviewer believes that the use of other material and checklists not developed by the PR Board is more appropriate in the review circumstances, the administering entity should be consulted in advance to assist in determining if that is acceptable. However, while the PR Board may allow the use of certain alternative materials and checklists under the right circumstances, the reviewer is required to use the electronic MFC, FFC, and DMFC forms provided by the PR Board for all peer reviews and alternative forms are not acceptable.

Firm's Retention Responsibilities

The reviewed firm is required to retain the report, letter of response, FFC form(s), letter documenting firm's compliance with required corrective or monitoring activities, and letter received from the administering entity accepting the report. These should be retained at least until the next review.

Reviewer's Retention Responsibilities

The reviewer and administering entity are responsible for the retention and destruction of workpapers prepared during the review. General peer review workpapers are typically retained for 120 days after the peer review is completed. (If the firm is involved in a noncooperation issue with the administering entity, or an appeal is in process for another reason, review workpapers will be retained longer.) Additionally, the following specific documents are retained by the reviewing firm and administering entity until after the firm's next peer review has been completed:

- Peer review report and the firm's response, if applicable.
- Letter notifying the firm that its peer review has been accepted.
- Letter indicating that the peer review documents have been accepted with the understanding that the firm agrees to take certain actions, if applicable. (The administering entity retains the copy signed by the firm.)
- Letter notifying the firm that certain required actions have been completed, if applicable.
- FFC forms, if applicable.
- Letter requesting the reviewed firm's completion of an implementation plan, if applicable. (The administering entity retains the copy signed by the firm.)
- Letter notifying the firm that the implementation plan has been completed, if applicable.
- Letter(s) relating to peer review document recall considerations, if applicable.
- Written representations from management of the reviewed firm.
- Scheduling information.

Administering entities may also retain the following administrative materials until the firm's subsequent peer review has been completed:

- Engagement letters.
- Review team appointment acceptance letters.
- Due date extension and year end change requests and approvals.
- Settlement agreements received by the administering entity from the AICPA Professional Ethics Division relating to individual members' performance on accounting, auditing, and attestation engagements.

Additional FDICIA Guidelines for Retention

As discussed earlier in this lesson, firms that perform audits subject to the FDIC Improvement Act of 1991 (FDICIA) are required to have a peer review that includes the review of at least one audit subject to the Act. Participation in the AICPA's Peer Review Program is acceptable, provided the review workpapers are retained by the reviewing firm for 120 days *after the review report is filed with the FDIC*, and the workpapers applicable to the review of engagement(s) subject to the FDICIA are made available to the FDIC, upon request. The reviewing firm or administering state society should therefore retain the workpapers for the 120-day period. (As previously noted, the firms should consider confirming those arrangements in the engagement letter.)

SELF-STUDY QUIZ

Determine the best answer for each question below. Then check your answers against the correct answers in the following section.

20. Which of the following should always be included in a system review report?

    a. Descriptions of deficiencies.

    b. A paragraph that states whether or not there was a scope limitation.

    c. A statement that the review was performed in accordance with QC 10.

    d. A scope paragraph and an opinion paragraph.

21. Which of the following firms could exclude an engagement from peer review without getting a scope limitation?

    a. Horowitz & Hughes stores workpapers for that engagement in an off-site warehouse and getting them will add time to the review.

    b. Alston & Newton have access to the relevant workpapers, but they no longer perform services for this specific client.

    c. Brinkman & Kinch's client refuses to give permission for the workpapers to be reviewed due to client confidentiality.

    d. Mycroft & Fields had this particular engagement chosen during its last peer review and would prefer the review team choose a different one.

22. Which of the following statements best describes the acceptance of a system review?

    a. The review must be accepted by the reviewed firm and the peer reviewer.

    b. A technical review is performed before the review is accepted.

    c. Corrective actions prior to acceptance come from the peer reviewer.

    d. The complete workpapers of an accepted peer review must be made available to the public.

23. The CPA firm of Jenkins & Jenkins does not pay the fees and expenses of its peer reviewer in a timely fashion. The firm may face which of the following consequences?

    a. Referral to the AICPA Professional Ethics Division.

    b. Termination from the peer review program.

    c. A hearing with the PR Board.

    d. Recall of its peer review documents.

24. Which of the following documentation should be retained by the reviewed firm?

    a. The peer review report.

    b. Scheduling information.

    c. Engagement letters.

    d. Written representations from management.

SELF-STUDY ANSWERS

This section provides the correct answers to the self-study quiz. If you answered a question incorrectly, reread the appropriate material. **(References are in parentheses.)**

20. Which of the following should always be included in a system review report? **(Page 85)**

    a. Descriptions of deficiencies. [This answer is incorrect. Descriptions of deficiencies, including reference to the applicable QC standard, the scenario that led to the deficiencies or significant deficiencies, and reference to any nonconforming engagements that resulted should be included in a peer review report with a rating of *pass with deficiencies* or *fail*. Therefore, this would not be included in the report with a peer review rating of *pass*.]

    b. A paragraph that states whether or not there was a scope limitation. [This answer is incorrect. In the event of a scope limitation, an additional paragraph is added 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 for the engagement(s) excluded from potential selection, and the effect of the exclusion on the scope and results of the peer review. However, if there is no scope limitation, a paragraph on this topic would not be included.]

    c. A statement that the review was performed in accordance with QC 10. [This answer is incorrect. According to the Peer Review Standards, the written report for a system review should state that the review was conducted in accordance with the standards established by the PR Board of the AICPA, not QC 10.]

    d. A scope paragraph and an opinion paragraph. [This answer is correct. The PR Board revised the format and certain language in the system review report effective for reviews commencing on or after January 1, 2017. The changes include, among other things, a revised title and headings for each section of the report. The report continues to include a scope paragraph and an opinion paragraph.]

21. Which of the following firms could exclude an engagement from peer review without getting a scope limitation? **(Page 87)**

    a. Horowitz & Hughes stores workpapers for that engagement in an off-site warehouse and getting them will add time to the review. [This answer is incorrect. This is an unacceptable reason for excluding an engagement from peer review, per the Peer Review Standards; therefore, Horowitz & Hughes may face a scope limitation.]

    b. Alston & Newton have access to the relevant workpapers, but they no longer perform services for this specific client. [This answer is incorrect. If the firm of Alston & Newton excludes this engagement from peer review, it may receive a scope limitation, because this reason is unacceptable under the Peer Review Standards.]

    c. Brinkman & Kinch's client refuses to give permission for the workpapers to be reviewed due to client confidentiality. [This answer is correct. Scope limitations occur when the reviewed firm refuses to allow workpapers of certain engagements to be reviewed. Such restrictions can be for legitimate reasons, according to the Peer Review Standards. One such legitimate reason is if the client refuses to allow the workpapers to be reviewed. Merely refusing to allow an engagement to be reviewed does not automatically result in a scope limitation that must be reported. With approval by the administering entity, Brinkman & Kinch can substitute another engagement and not have a scope limitation.]

    d. Mycroft & Fields had this particular engagement chosen during its last peer review and would prefer the review team choose a different one. [This answer is incorrect. Under the peer review standards, this is an unacceptable reason for excluding an engagement from peer review. Mycroft & Fields may have a scope limitation on its peer review report if it does not allow the peer review team to review this engagement.]

22. Which of the following statements best describes the acceptance of a system review? **(Page 91)**

   a. The review must be accepted by the reviewed firm and the peer reviewer. [This answer is incorrect. The final step in the peer review process is the acceptance of the review by the administering entity peer review committee (not the reviewed firm and the peer reviewer).]

   b. A technical review is performed before the review is accepted. [This answer is correct. Technical reviews are required on all peer reviews. It is not uncommon for issues to arise as part of the technical review, and any such issues need to be resolved between the technical reviewer and the peer reviewer before the peer review is submitted for acceptance.]

   c. Corrective actions prior to acceptance come from the peer reviewer. [This answer is incorrect. The administering entity peer review committee may require additional corrective actions or monitoring actions as a condition of its acceptance of a review.]

   d. The complete workpapers of an accepted peer review must be made available to the public. [This answer is incorrect. Reviewed firms that are members of PCPS, the AICPA Government Audit Quality Center, or the AICPA Employee Benefit Plan Audit Quality Center must make publicly available, for their most recently accepted peer review, the peer review report and the letter of response, if applicable. The complete workpapers do not need to be made available.]

23. The CPA firm of Jenkins & Jenkins does not pay the fees and expenses of its peer reviewer in a timely fashion. The firm may face which of the following consequences? **(Page 92)**

   a. Referral to the AICPA Professional Ethics Division. [This answer is incorrect. This could occur if the problem is related to the firm not accurately representing its accounting and auditing practice or subsequently failing to submit a peer review by the required date, the matter will result in a referral to the AICPA Professional Ethics Division for investigation of a possible violation of the *Code of Professional Conduct*. However, since Jenkins & Jenkins did not err in either of these areas, this referral will not occur.]

   b. Termination from the peer review program. [This answer is correct. At the time of enrollment in the AICPA Peer Review Program, one of the responsibilities that a firm accepts is to cooperate with the peer reviewer, administering entity, and the PR Board in all matters related to the peer review. If the PR Board determines that a firm is not cooperating, the firm's enrollment can be dropped, without a hearing, 30 days after the AICPA Peer Review Program notifies the firm by certified mail that the firm has failed to meet certain requirements. One such requirement is to timely pay in full the fees and expenses of the review team formed by the administering entity.]

   c. A hearing with the PR Board. [This answer is incorrect. A firm suspected of failing to cooperate will be advised by certified mail that the PR Board will appoint a hearing panel to consider whether the firm's enrollment in the program should be terminated. Failure to cooperate includes, among other things, not arranging the exit conference on a timely basis, failing to cooperate during oversight, and failing to timely acknowledge and complete required corrective actions or implementation plans. Jenkins & Jenkins actions do not fall under this failure to cooperate category, so their consequences would differ.]

   d. Recall of its peer review documents. [This answer is incorrect. If a firm either omits or misrepresents information about its accounting and auditing practice that results in a material departure in the firm's most recently accepted peer review, acceptance of the peer review documents will be recalled. However, since that is not the problem with Jenkins & Jenkins in this scenario, this should not occur.]

24. Which of the following documentation should be retained by the reviewed firm? **(Page 95)**

   a. **The peer review report. [This answer is correct. The reviewed firm is required to retain only the report, letter of response, FFC form(s), letter documenting the firm's compliance with required corrective or monitoring activities, and the letter received from the administering entity accepting the report.]**

   b. Scheduling information. [This answer is incorrect. Scheduling information is part of the documentation that should be retained by the peer reviewer, not the reviewed firm.]

   c. Engagement letters. [This answer is incorrect. Engagement letters are part of the documentation that the administering entity may retain, not the reviewed firm.]

   d. Written representations from management. [This answer is incorrect. Written representations from the reviewed firm's management are part of the peer reviewer's retention responsibilities, not those of the reviewed firm.]

EXAMINATION FOR CPE CREDIT

Companion to PPC's Guide to Quality Control—Course 1—The Basics of Quality Control, the Peer Review Process, and Undergoing a System Review (GQCTG181)

Testing Instructions

1. Following these instructions is an **EXAMINATION FOR CPE CREDIT** consisting of multiple choice questions. You may print and use the **EXAMINATION FOR CPE CREDIT ANSWER SHEET** to complete the examination. This course is designed so the participant reads the course materials, answers a series of self-study questions, and evaluates progress by comparing answers to both the correct and incorrect answers and the reasons for each. At the end of the course, the participant then answers the examination questions and records answers to the examination questions on either the printed **Examination for CPE Credit Answer Sheet** or by logging onto the Online Grading System. The **Examination for CPE Credit Answer Sheet** and **Self-study Course Evaluation Form** for each course are located at the end of all course materials.

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   PRINT GRADING. If you prefer, you may email, mail, or fax your completed answer sheet, as described below ($95 for email or fax; $105 for regular mail). The answer sheets are found at the end of the course PDFs. Answer sheets may be printed from the PDFs; they can also be scanned for email grading, if desired. The answer sheets are identified with the course acronym. Please ensure you use the correct answer sheet. Indicate the best answer to the exam questions by completely filling in the circle for the correct answer. The bubbled answer should correspond with the correct answer letter at the top of the circle's column and with the question number. You may submit your answer sheet for grading three times. After the third unsuccessful attempt, another payment is required to continue.

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   Note: The answer sheet has four bubbles for each question. However, if there is an exam question with only two or three valid answer choices, "Do not select this answer choice" will appear next to the invalid answer choices on the examination.

2. If you change your answer, remove your previous mark completely. Any stray marks on the answer sheet may be misinterpreted.

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EXAMINATION FOR CPE CREDIT

Companion to PPC's Guide to Quality Control—Course 1—The Basics of Quality Control, the Peer Review Process, and Undergoing a System Review (GQCTG181)

Determine the best answer for each question below. Then mark your answer choice on the Examination for CPE Credit Answer Sheet. The answer sheet can be printed out from the back of this PDF or accessed by logging onto the Online Grading System.

1. A firm with which of the following is required to follow the quality control (QC) standards?

   a. A consulting practice.

   b. A tax practice.

   c. An accounting and auditing practice.

   d. A valuation practice.

2. The nature of the policies and procedures that make up a firm's QC system will depend on all of the following, **except**:

   a. Firm size.

   b. Services provided.

   c. Industries served.

   d. Partners' salaries.

3. What are the elements of quality control described in QC 10.17?

   a. Leadership responsibilities for firm quality, professional requirements, acceptance and continuance, engagement performance, mentoring, and monitoring.

   b. Leadership responsibilities for firm quality, relevant ethical requirements, acceptance and continuance, human resources, engagement performance, and monitoring.

   c. Relevant ethical requirements, professional requirements, mentoring, human resources, engagement performance, and engagement follow-up.

   d. Quality control materials, licensing requirements, advertising, hiring and recruitment, engagement performance, and engagement follow-up.

4. Which of the following must a firm do under QC 10?

   a. Have a formal QC policies and procedures document.

   b. Document its policies and procedures in relation to its unique circumstances.

   c. Prepare a QC document specifically for use by peer reviewers.

   d. Communicate its policies and procedures to firm personnel in writing.

5. What piece of authoritative guidance should a firm consult for information on implementing each element of quality control into audits of financial statements?

   a. AR-C 60.

   b. AU-C 220.

   c. The AICPA *Code of Professional Conduct.*

   d. The Peer Review Standards.

6. A firm's commitment to quality should move in which direction?

   a. From the top down.

   b. From the bottom up.

   c. From the inside out.

   d. From the outside in.

7. If a firm is able to establish and maintain an effective QC system, it is likely to experience which of the following?

   a. Lower quality of work.

   b. Higher risk of litigation.

   c. Higher staff morale.

   d. Less efficiency delivering services.

8. When following the timetable outlined in this course for implementing a QC system, how long is the peer review period?

   a. Two months.

   b. Four months.

   c. Twelve months.

   d. Eighteen months.

9. Which of the following are used to assist firms with performing and reporting in conformity with applicable professional standards?

   a. The quality control document.

   b. Quality control materials (QCM).

   c. A bridging document.

   d. A QC maintenance calendar.

10. Which of the following helps a firm to remember to perform administrative tasks critical to the QC system?

    a. The quality control document.

    b. QCM.

    c. A bridging document.

    d. A QC maintenance calendar.

11. In what order were the following peer review and quality control institutions put in place (list from oldest to newest)?

    a. The Private Companies Practice Section (PCPS) and the SEC Practice Section (SECPS); the Quality Review Division and the Quality Review Executive Committee; the AICPA Peer Review Program; the Public Company Accounting Oversight Board (PCAOB); the Center for Public Company Audit Firms (CPCAF); the Center for Audit Quality (CAQ).

    b. The Quality Review Division and the Quality Review Executive Committee; the PCPS and the SECPS; the CPCAF; the CAQ; the PCAOB; the AICPA Peer Review Program.

    c. The PCPS and the SECPS; the Quality Review Division and the Quality Review Executive Committee; the CPCAF; the PCAOB; the CAQ; the AICPA Peer Review Program.

    d. The CAQ; the CPCAF; the PCAOB; the AICPA Peer Review Program; the Quality Review Division and the Quality Review Executive Committee; the PCPS and the SECPS.

12. The AICPA has formed centers to improve quality in which two areas?

    a. Public company and nonpublic company audits.

    b. Governmental audits and audits of employee benefit plans.

    c. Practices of public and nonpublic securities broker-dealers.

    d. State licensing and practice monitoring.

13. Which of the following CPA firms is demonstrating transparency?

    a. Red Firm keeps its most recent peer review report confidential because of a rating of fail.

    b. Blue Firm is subject to enhanced oversight by the Peer Review Oversight Committee.

    c. Green Firm allows its most recent peer review report in a public file on the AICPA website.

    d. Yellow Firm undergoes a peer review at the appropriately scheduled time.

14. Undergoing peer review will benefit a CPA firm in which of the following ways?

    a. Keeping their issues confined within the firm.

    b. Lower staff morale.

    c. Correcting issues before litigation occurs.

    d. The public's interest is better served.

15. Which of the following firms is required to have a system review?

    a. Number Crunchers performs a review of historical financial statements under AR-C 90.

    b. Accountants 'R Us performs a preparation of historical financial statements under AR-C 70.

    c. CPA Time performs general examinations under AT-C 205.

    d. Professional Associates performs compilations of pro forma financial information under AR-C 120.

16. Who is responsible for administering and approving peer reviews?
    a. The AICPA.
    b. The reviewed firm.
    c. The reviewer firm.
    d. The state society.
17. Who pays the cost of a peer review?
    a. The AICPA.
    b. The reviewed firm.
    c. The reviewer firm.
    d. The state society.
18. Which of the following will help a firm have a more efficient and cost-effective peer review?
    a. Limiting information about the review to management and those directly involved.
    b. Allow the reviewers to assist with documentation in engagement workpapers.
    c. Having information available for the reviewers upon their arrival at the firm.
    d. Ensuring that engagement staff follow appropriate professional standards.
19. Which of the following statements best describes a system review?
    a. System review reports are accepted and reviewed by the reviewer firm.
    b. The reviewer determines whether QC policies have been complied with.
    c. The reviewer tests each of the engagements performed by the reviewed firm during the period.
    d. System reviews are performed in the reviewer firm's office with information sent by the reviewed firm.
20. What are the two options for organizing a system review team?
    a. Firm-on-firm or Peer Review (PR) Board.
    b. Firm-on-firm or self-review.
    c. Association of CPA firms and PR Board.
    d. Firm-on-firm or association of CPA firms.
21. The administering entity is responsible for which of the following?
    a. Providing information about the review team.
    b. Approving the review team.
    c. Setting the timing of the peer review.
    d. Making sure the review team has the necessary experience.

22. An administering entity would be most likely to grant a due-date extension to which of the following firms?

    a. Firm W is relocating to a new office.

    b. Firm X does not yet have its QC system in place.

    c. Firm Y needs time to complete a small engagement.

    d. Firm Z's review conflicts with its busy season.

23. Is a firm allowed to exclude engagements from the scope of a peer review?

    a. No, excluding engagements will be considered an automatic scope limitation.

    b. No, an engagement cannot be excluded from a peer review, unless it is not part of the firm's accounting and auditing hours.

    c. Yes, if the reason why satisfies the administering entity, an engagement can be excluded without a scope limitation.

    d. Yes, the firm is allowed to exclude some engagements, as long as there are enough engagements to fill the reviewers' needs.

24. The CPA firm of Daniels & Michaelson uses QCM from a third-party provider as part of its QC system. Which of the following actions will the firm need to take related to its QCM when it undergoes system review?

    a. Provide the QCM provider's most recent peer review report to the firm's reviewer.

    b. Know that the reviewer will put at least some reliance on the QCM.

    c. Review the AICPA *Peer Review Program Manual* and compare it to the QCM.

    d. Provide the reviewer a statement of the firm's philosophy related to the QCM.

25. If a CPA firm has a review year that runs from April 1 through March 31, by what date should it select the team for its system review?

    a. February 15.

    b. April 1.

    c. May 15.

    d. June 15.

26. Which of the following types of office must a peer review team always visit?

    a. An office that has recently opened or merged.

    b. An office that provides services in a variety of industries.

    c. An executive office.

    d. Reviewers must visit all of a firm's offices.

27. Jacob's firm accepts a peer review engagement. Jacob will captain the team performing the system review on a slightly smaller firm with similar practice areas. Jacob and his team perform all of the following procedures during the system review. Which one would be considered *fieldwork*?

    a. Preparing the written system review report.

    b. Reviewing the design of the client firm's QC system.

    c. Obtaining an understanding of the client firm's accounting and auditing practice.

    d. Assessing the amount of peer review risk associated with the engagement.

28. The CPA firm of Michelson & Tait hires Graham's firm to perform its system review. Graham serves as the system review team captain. Michelson & Tait performs a significant number of audit engagements as part of their practice. When Graham and his team review some of the firm's audit engagement as part of the system review, which of the following is an additional task they will need to perform that they would not need to perform for other engagements, such as compilations?

    a. Determine whether the financial statements were presented in accordance with GAAP or a special purpose framework.

    b. Check to see if the report was presented in accordance with professional standards.

    c. Make sure the firm complied with its QC policies and procedures.

    d. Identify significant risk areas.

29. After the review team has reached its conclusion, whose responsibility is it to investigate any issues raised and take corrective action?

    a. The peer reviewer.

    b. The reviewed firm.

    c. The administering entity.

    d. The Peer Review Board.

30. Which of the following are reported in the peer review report instead of on a separate form?

    a. Matters.

    b. Findings and matters.

    c. Findings and deficiencies.

    d. Deficiencies and significant deficiencies.

31. Which of the following firms would receive a peer review report with the rating of *pass with deficiencies*?

    a. The Golden Firm's QC system is suitably designed and complied with.

    b. The Silver Firm's QC system has matters for further consideration, but no deficiencies.

    c. The Copper Firm's QC system is suitably designed and complied with except for one specific deficiency.

    d. The Bronze Firm's QC system has significant deficiencies in design so that there is no reasonable assurance that professional standards are being complied with.

32. What is the final step in the fieldwork stage of a system review?

    a. Providing firm representations.

    b. Attending exit conference.

    c. Determining what kind of report to issue.

    d. Transferring the review to the reviewer firm's office.

33. Marilyn's firm accepts an engagement to perform a system review. Marilyn is selected to be the review team captain. The team finishes the system review fieldwork on May 31. By what date must she provide a written report to the reviewed firm?

    a. May 31.

    b. June 15.

    c. June 30.

    d. July 30.

34. Which of the following would only be included in a system review report with a rating of *pass*?

    a. An opinion that the QC system for the A&A practice was suitably designed and complied with.

    b. A statement that the firm's QC system for its A&A practice was reviewed and includes the year-end covered by this peer review.

    c. Identification of any deficiencies or significant deficiencies that were included in the prior year's system review report based on their systemic cause.

    d. Identification and descriptions of the different peer review ratings that the firm could receive during a system review.

35. Carlos is assigned to be team captain when his firm performs a system review for Small Town CPAs. During the review, Carlos discovers multiple engagements where the firm did not prepare appropriately detailed audit programs and missed performing key procedures. The firm also failed to provide the level of documentation required by professional standards on several engagements. The firm's QC system requires such actions be taken; therefore, Carlos determines that the Small Town CPAs is not adequately complying with its QC system. What rating should Carlos and his team give to Small Town CPAs after this system review?

    a. Pass.

    b. Pass, but note a scope limitation.

    c. Pass with deficiencies.

    d. Fail.

36. If a firm receives a peer review rating of *pass with deficiencies* or *fail*, how should it respond?

    a. It should discuss the deficiencies and significant deficiencies orally with the team captain.

    b. It should write a letter of response and submit it to the team captain before the exit conference.

    c. It should file two copies of its review report and related corrective actions and let the reviewer firm know within 15 days.

    d. It should allow the team captain to submit the letter of response to the administering entity.

37. If a deficiency noted in the firm's previous system review report is noted again in the current year's report, it is called which of the following?

    a. A significant deficiency.

    b. A repeat deficiency.

    c. A matter for further consideration.

    d. A finding.

38. In what order do the following events generally occur at the conclusion of a system review?

    a. The team captain issues the review report; the exit conference is held; the reviewed firm submits the documents and letter of response (if applicable) to the administering entity; the report is considered for approval by the administering entity peer review committee.

    b. The team captain issues the review report; the reviewed firm submits the documents and letter of response (if applicable) to the administering entity; the report is considered for approval by the administering entity peer review committee; the exit conference is held.

    c. The exit conference is held; the team captain issues the review report; the reviewed firm submits the documents and letter of response (if applicable) to the administering entity; the report is considered for approval by the administering entity peer review committee.

    d. The exit conference is held; the report is considered for approval by the administering entity peer review committee; the team captain issues the review report; the reviewed firm submits the documents and letter of response (if applicable) to the administering entity.

39. If the reviewed firm and the peer reviewer have a disagreement, which entity has the highest authority for making the final determination?

    a. An ad hoc committee formed by the Peer Review Board.

    b. The peer reviewer.

    c. The administering entity.

    d. A panel of the administering entity's peer review committee.

40. How could a reviewing firm's failure to complete relevant materials and checklists issued by the Peer Review Board affect a system review?

    a. As long as alternate versions of the materials and checklists, including MFC forms, are used, the review should not be affected.

    b. As long as the work performed was documented in the engagement workpapers, the review should not be affected.

    c. It could create the presumption that the review was not performed in accordance with the Peer Review Standards.

    d. The peer review result given to the reviewed firm could be overturned by the administering entity.

GLOSSARY

Accounting and auditing practice: According to QC 10.13, this is a practice that performs audit, attestation, compilation, review, and any other services for which standards have been established by the AICPA Auditing Standards Board (ASB) or the AICPA Accounting and Review Services Committee (ARSC) under the *General Standards Rule* and the *Compliance with Standards Rule* of the AICPA *Code of Professional Conduct*. According to the Peer Review Standards, this consists of engagements performed under the SASs, SSARS (excluding those engagements that SSARS has provided an exemption for), SSAEs, *Government Auditing Standards* (the Yellow Book) issued by the GAO, and PCAOB standards.

Adaptability: The willingness to change and support change.

Administering entity: The state society responsible for administering a state's peer review program.

Alternative practice structure (APS): A nontraditional structure in which nonattest services are performed under public or private partnership and attest services are performed through a separate firm owned and controlled by a member.

Association review: Firms that belong to an association of CPAs may ask their association to assist in forming a team for their peer review. Some associations require members to have their peer reviews arranged by the association as a condition of membership.

Bridging document: A document that creates a bridge between a firm's *quality control document* and its *QCM*. It should specify which procedures in the QCM being used by the firm.

Commencement date: The date that the peer review team begins fieldwork or work on the engagement (e.g., if the review team started reviewing engagements before the team captain started fieldwork).

Deficiency: One or more *findings* that the peer review concludes could create a situation in which the firm would not have reasonable assurance of performing and/or reporting in conformity with applicable professional standards in one or more important respects.

Due date: The date by which the peer reviewer's materials, the report, and if applicable, the letter of response are to be completed and submitted to the administering entity.

Elements of quality control: Leadership responsibilities for quality within the firm, acceptance and continuance of client relationships and specific engagements, human resources, engagement performance, and monitoring.

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

Engagement quality control review (EQCR): A process designed to provide an objective evaluation, before the report is released, of the significant judgments made and the conclusions reached by the engagement team. This process is only for those engagements, if any, for which an EQCR is required by the firm's policies and procedures.

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

Engagement review: A periodic peer review of a firm's engagements.

Engagement team: All partners and staff performing the engagement and any individuals engaged by the firm or a network firm who perform procedures on the engagement, excluding external specialists engaged by the firm or a network firm and internal auditors providing direct assistance on an audit engagement.

Finding: One or more related *matters* such that there is more than a remote possibility that the reviewed firm would not perform and/or report in conformity with professional standards.

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

Firm culture: The shared assumptions, beliefs, and behaviors of firm personnel.

Firm-on-firm review: The reviewed firm selects another CPA firm to conduct its peer review.

Inspection: A retrospective evaluation of the adequacy of the firm's quality control policies and procedures, its personnel's understanding of those policies and procedures, and the extent of the firm's compliance with them. It includes a review of completed engagements.

Material departure: A departure resulting in a peer review that was not properly performed or reported on in all material respects, thus necessitating a significant change in the peer review report.

Matter: Items identified through the peer reviewers' evaluation of the design of the reviewed firm's system of quality control and/or tests of compliance with it. They are often represented as "no" answers to questions in a peer review questionnaire that warrant further consideration.

Monitoring: An ongoing consideration and evaluation of the firm's *system of quality control*, including *inspection* or a periodic review of engagement documentation, reports, and clients' financial statements for a selection of completed engagements, that is designed to provide the firm with reasonable assurance that its system of quality control is designed appropriately and operating effectively.

Network: An association of entities, as defined in the AICPA *Code of Professional Conduct*.

Network firm: A firm or other entity that belongs to a network, as defined in ET 0.400.34.

Partner: Any individual with authority to bind the firm with respect to the performance of a professional services engagement. For purposes of this definition, *partner* may include an employee with this authority who has not assumed the risks and benefits of ownership. Firms may use different titles to refer to individuals with this authority.

Peer review risk: The risk that the peer review team will (1) fail to identify significant weaknesses in the reviewed firm's system of quality control and/or its lack of compliance with the system; (2) issue an inappropriate opinion on the reviewed firm's system of quality control and/or its compliance with the system; or (3) reach an inappropriate decision about the matters to be included in, or excluded from, the report.

Personnel: Partners and staff.

Positive reinforcement programs: Various forms of quality control reviews required by state boards. Compliance with such programs does not eliminate the firm's need to comply with the AICPA practice monitoring requirement for peer reviews.

Presumptively mandatory requirements: Firms are expected to comply with such requirements if the circumstances apply; however, in rare situations, a departure from the requirement is allowed if the firm documents the justification and how alternative procedures that were performed were sufficient to achieve the objectives of the requirement. They are identified by the word *should*.

Professional standards: Standards established by the ASB or ARSC under the *General Standards Rule*, the *Compliance with Standards Rule*, or other standards-setting bodies that set auditing and attest standards applicable to the engagement being performed and relevant ethical requirements.

Public Company Accounting Oversight Board (PCAOB): Created by the Sarbanes-Oxley Act of 2002, the PCAOB has the authority to establish audit, attestation, quality control, ethics, independence, and other standards relating to audits; conduct inspections of accounting firms that have public company clients; and impose sanctions for violations of its standards and rules.

Public company client: According to the Sarbanes-Oxley Act of 2002 and the PCAOB, this is an issuer as defined in Section 3 of the Securities Exchange Act of 1934, the securities of which are registered under Section 12 of that Act; that is required to file reports under Section 15(d); or that files or has filed a registration statement that has not yet become effective under the Securities Act if 1933 and that it has not withdrawn.

Public practice: The performance of professional services for a client by an AICPA member or a member's firm.

Quality: A degree or grade of excellence.

Quality control document: The written form of the *system of quality control* made up of the documented policies and procedures and the related forms, checklists, etc., that support those policies and procedures.

Quality control materials (QCM): Accounting and auditing manuals developed by other large accounting firms or commercial publishers, which firms can adopt or adapt for their quality control system.

Reasonable assurance: In the context of SQCS No. 8, a high, but not absolute, level of assurance.

Reciprocal review: A situation in which (1) one firm performs the review of the firm that performed its most recent peer review or (2) a reviewer serves on a review team carrying out a review of a firm whose personnel participated in the most recent review of that reviewer's firm.

Relevant ethical requirements: Ethical requirements to which the firm and its personnel are subject, which consist of the AICPA *Code of Professional Conduct* together with rules of applicable state boards of accountancy and applicable regulatory agencies that are more restrictive.

Significant deficiency: One or more *deficiencies*, if the reviewer concludes the situation results in note providing the reviewed firm with reasonable assurance of performing and/or reporting in conformity with applicable professional standards in all material respects.

Staff: Professionals, other than partners, including specialists that the firm employs.

Suitably qualified external person: An individual outside the firm with the competence and capabilities to serve as an engagement partner (e.g., a partner of another firm).

System of quality control: A system of policies and procedures designed to provide the firm with reasonable assurance that (1) the firm and its personnel are complying with professional standards and applicable legal and regulatory requirements and (2) that reports issued by the firm are appropriate in the circumstances.

System review: A periodic peer review of a firm's system of quality control.

Transparency: Making information about a firm's peer review publically available (e.g., putting the peer review report and letter of response, if applicable, in a public file accessible from the AICPA's website).

Unconditional requirements: Firms must follow such requirements in all cases if the circumstances apply. They use the word *must*.

INDEX

This index is a list of general topics discussed in this course. More specific key word searches can be performed using the search feature of this PDF.

A

ACCEPTANCE OF PEER REVIEW
- Press releases . . . 91
- Public availability of peer review results . . . 91
- Timetable for report acceptance . . . 91

ACCOUNTING AND AUDITING HOURS . . . 53

ACCOUNTING AND AUDITING PRACTICE
- Defined . . . 3, 34
- Internal use forecast and projection engagements . . . 35
- Prep of f/s subject to peer review . . . 34
- Services covered . . . 34

AICPA PRACTICE AID
- Considering . . . 20

ASSIGNMENT OF RESPONSIBILITIES FOR THE QC SYSTEM
- Quality control director . . . 45

ATTESTATION ENGAGEMENTS . . . 34

C

***CODE OF PROFESSIONAL CONDUCT,* AICPA**
- Confidentiality . . . 57

COMMITMENT TO QUALITY
- Benefits of establishing and maintaining an effective QC system . . . 15
- Dedication of time and resources . . . 14
- Effective leadership . . . 14
- Firm culture . . . 14

D

DEVELOPING AND IMPLEMENTING AN EFFECTIVE QC SYSTEM
- Assessing the current QC system and establishing a plan . . . 17
- Communicating the QC policies and procedures . . . 18
- Developing the QC policies and procedures . . . 17
- Monitoring implementation of the QC system . . . 18
- Performing monitoring procedures on the system . . . 18
  - Obtaining external QC consulting assistance . . . 18
- Reviewing relevant professional literature . . . 17
- Reviewing the implementation plan and timetable with partners . . . 17
- Setting a realistic timetable for implementation . . . 17

DRAFTING QC POLICIES AND PROCEDURES
- Considering the AICPA Quality Control Practice Aid . . . 20
- Creating a comprehensive quality control document . . . 19
- Referring to personnel and accounting and auditing manuals . . . 19
  - Quality control materials (QCM) . . . 19
  - The use of abbreviated QC documents . . . 19

E

EVOLUTION OF THE PEER REVIEW PROCESS
- AICPA Peer Review Program . . . 27
- AICPA Quality Review Program . . . 27
- Employee Benefit Plan Audit Quality Center . . . 30
- Enhancing audit quality initiative . . . 31
- Evolution of non-SEC peer review for PCAOB registered firms . . . 28
- Governmental Audit Quality Center . . . 29
- Public Company Accounting Oversight Board . . . 28
  - PCAOB interim nonpublic broker-dealer inspection program . . . 29
- Transparency . . . 30

EXAMINATIONS . . . 34

F

FDIC IMPROVEMENT ACT OF 1991 . . . 51, 96

L

LETTER OF RESPONSE . . . 89

M

MAINTAINING THE FIRM'S QC SYSTEM
- QC maintenance calendar drafting form . . . 20

P

***PEER REVIEW PROGRAM MANUAL* (AICPA) . . . 25, 55**

PEER REVIEWS (AICPA)
- Accounting and auditing practice . . . 34
- AICPA contact information . . . 39
- Benefits of . . . 32
- Cost of . . . 38
- Engagement letters . . . 51
- FAQs . . . 40
- Joining . . . 32
- Objectives and requirements . . . 33
- Press releases . . . 91
- Record retention . . . 95
- State positive enforcement programs . . . 57
- State society involvement . . . 37
- Termination from program . . . 92
- Timing of reviews . . . 36, 49
- Types of . . . 35

Q

QUALITY CONTROL SYSTEM—DESIGN
- What is quality control? . . . 3
- What is the purpose of a quality control system? . . . 4
- Who is this course designed for? . . . 4

S

SQCS NO. 8 AND OTHER ENGAGEMENT-LEVEL QC REQUIREMENTS
- Auditing QC-related standard (AU-C 220) . . . 8
- Documentation and communication of the firm's QC policies and procedures . . . 6
- Documentation requirements . . . 8
- Elements of a quality control system . . . 6
- Evolution of the QC standards . . . 4
- Factors that affect nature of the firm's QC policies and procedures . . . 5
- Professional requirements . . . 5
- SSAEs common concepts for QC . . . 8

***STANDARDS FOR PERFORMING AND REPORTING ON PEER REVIEWS* . . . 34, 45**

STATE BOARDS OF ACCOUNTANCY
- Confidential client information . . . 57
- Practice monitoring programs . . . 57

STATEMENTS ON STANDARDS FOR ACCOUNTING AND REVIEW SERVICES (SSARS) 34

STATE SOCIETIES OF CPAS
- Participation in peer reviews 37, 46

SYSTEM REVIEWS
- Accounting and auditing hours 53
- Administering entity 46
  - Acceptance of review 91
- AICPA PRPM 55
- Checklist for selecting a reviewing firm 48
- Choosing a peer reviewer 48
- Client confidentiality 57
- Commencement date 57
- Cost of 38
- Cost-savings measures 38, 79
- Date of review 49
- Disagreements 92
- Engagement letters 51
- Extensions 50
- Fieldwork procedures 67
- Firm background information 52
- Firms required to have a system review 45
- In-house seminar 55
- Letter of response 89
- License requirements 56
- MFC and FFC Forms 71
- Objectives 45
- Period reviewed 50
- Planning considerations 45, 62
- Planning timetable 57
- Positive enforcement programs 57
- Press releases 91
- Public availability of peer review results 91
- Record retention, firm 95
- Record retention, reviewer 95
- Request for extension 50
- Request for scheduling 46
- Review team considerations 46, 49
- Scope of review, excluding engagements from 54
- Selection of offices and engagements 64
- Selection of peer review year-end 50
- System review reports 85
- Termination from program 92

COMPANION TO PPC'S GUIDE TO QUALITY CONTROL

COURSE 2

CLIENT ACCEPTANCE AND CONTINUANCE AND HUMAN RESOURCES (GQCTG182)

OVERVIEW

COURSE DESCRIPTION:	This interactive self-study course discusses two elements of quality control, related information in the quality control standards, and the quality control (QC) policies and procedures firms will need in these areas for a robust QC system. Lesson 1 takes a look at the requirements for acceptance and continuance of client relationships and specific engagements. Lesson 2 examines issues related to human resources.
PUBLICATION/REVISION DATE:	April 2018
RECOMMENDED FOR:	Users of *PPC's Guide to Quality Control*
PREREQUISITE/ADVANCE PREPARATION:	Basic knowledge of the quality control requirements
CPE CREDIT:	8 NASBA Registry "QAS Self-Study" Hours This course is designed to meet the requirements of the *Statement on Standards of Continuing Professional Education (CPE) Programs* (the *Standards*), issued jointly by NASBA and the AICPA. As of this date, not all boards of public accountancy have adopted the *Standards* in their entirety. For states that have adopted the *Standards*, credit hours are measured in 50-minute contact hours. Some states, however, may still require 100-minute contact hours for self study. Your state licensing board has final authority on acceptance of NASBA Registry QAS self-study credit hours. Check with your state board of accountancy to confirm acceptability of NASBA QAS self-study credit hours. Alternatively, you may visit the NASBA website at **www.nasbaregistry.org** for a listing of states that accept NASBA QAS self-study credit hours and that have adopted the *Standards*.
FIELD OF STUDY:	Business Management & Organization
EXPIRATION DATE:	Postmark by **April 30, 2019**
KNOWLEDGE LEVEL:	Basic

Learning Objectives:

Lesson 1—Acceptance and Continuance of Client Relationships and Specific Engagements

Completion of this lesson will enable you to:

- Recognize issues related to firm competence and capabilities, compliance with legal and ethical requirements, the integrity of the client, and other considerations.
- Identify how to address obtaining an understanding with the client; when to pursue withdrawal from an engagement or client relationship; and how to draft appropriate QC policies and procedures and evaluate the adequacy of the QC system's design.

Lesson 2—Human Resources

Completion of this lesson will enable you to:

- Recognize issues related to recruitment and hiring, competencies and capabilities, and assigning staff to engagement teams.

- Determine appropriate responses and strategies for professional development; performance evaluations, compensation, and advancement; drafting appropriate QC policies and procedures; and evaluating the QC system's design.

TO COMPLETE THIS LEARNING PROCESS:

Log onto our Online Grading Center at **cl.tr.com/ogs.** Online grading allows you to get instant CPE credit for your exam.

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Lesson 1: Acceptance and Continuance of Client Relationships and Specific Engagements

INTRODUCTION

A CPA firm is often faced with difficult decisions regarding acceptance and/or continuance of client relationships and engagements. Balancing a firm's economic needs against maintaining the integrity of the firm can be challenging, as the solutions to difficult client decisions are sometimes not clear—even to seasoned professionals. A firm's natural desire for growth can create pressure to accept or retain problematic clients or to continue relationships and engagements with marginally profitable clients. However, associating with an unethical client may also harm the firm's reputation. One questionable client may cause other clients to reevaluate the firm's ethics and integrity and prompt ethical clients to question their association with the firm.

On the other hand, practitioners generally recognize that selecting clients who run their businesses well and with integrity not only strengthens the firm's ability to provide high quality, profitable services, but also limits the risk of legal exposure or liability. Having robust client acceptance procedures also helps protect the firm by lessening the likelihood that the firm will provide services to an unethical client. Faced with opposing pressures, all firms, regardless of size, can benefit from a quality control (QC) system to evaluate the acceptance and continuance of clients and engagements. Along with instilling a reliable "tone at the top" firm culture, having robust policies and procedures over accepting and continuing client relationships and engagements is an effective upfront way for firms to control risk.

Learning Objectives:

Completion of this lesson will enable you to:

- Recognize issues related to firm competence and capabilities, compliance with legal and ethical requirements, the integrity of the client, and other considerations.
- Identify how to address obtaining an understanding with the client; when to pursue withdrawal from an engagement or client relationship; and how to draft appropriate QC policies and procedures and evaluate the adequacy of the QC system's design.

Authoritative Literature

This lesson provides information to assist firms in understanding and complying with the authoritative literature that addresses the acceptance and continuance of client relationships and specific engagements as part of the firm's system of quality control pursuant to SQCS No. 8, *A Firm's System of Quality Control* (QC 10). Additionally, the auditing, attestation, and compilation and review professional standards incorporate engagement-level quality control requirements leveraged from QC 10. AU-C 220, *Quality Control for an Engagement Conducted in Accordance with Generally Accepted Auditing Standards,* provides guidance specific to the performance of audit engagements, generally focusing on the responsibilities of the audit partner and engagement team. AT-C 105, *Common Concepts to All Attestation Engagements*, provides guidance indicating that the engagement partner should take responsibility for overall quality on each attestation engagement performed, including those related to the acceptance and continuance of client relationships and engagements. Similarly, AR-C 60, *General Principles for Engagements Performed in Accordance with Statements on Standards for Accounting and Review Services,* provides guidance related to the accountant's responsibility with regard to the acceptance and the continuance of client relationships and engagements under the SSARS.

Thus, all authoritative pronouncements over attest engagements (that is, the SASs, SSAEs, and SSARS) require firms and their engagement partners to adhere to the requirements of QC 10. Additionally, the authoritative literature of the AICPA *Code of Professional Conduct* (the Code), other AU-C sections, SSAE No. 18, and the SSARS all provide guidance that addresses the firm accepting and continuing client relationships and engagements. That information is discussed in various sections of this lesson.

Requirements

The requirements pursuant to the authoritative literature discussed in the preceding two paragraphs that relate to the acceptance and continuance of client engagements and specific engagements QC element are detailed in Exhibits 1-1 through 1-4.

Exhibit 1-1

Requirements for Acceptance and Continuance QC Policies and Procedures under QC 10

Requirements	QC 10
The firm should establish policies and procedures for accepting and continuing client relationships and specific engagements to provide reasonable assurance that the firm will undertake or continue relationships and engagements only when it— • Possesses the competence and the capabilities to perform the engagement, including the necessary time and resources, to do so. • Complies with applicable legal and ethical requirements. • Considers the client's integrity and does not discover information that indicates a lack of integrity by the client.	QC 10.27
Such policies and procedures should— • Require the firm to obtain information considered necessary in the circumstances before (1) a new client is accepted, (2) work on a continuing engagement begins, and (3) a new engagement with an existing client is accepted. • Require the firm to determine the appropriateness of accepting the engagement if a potential conflict of interest is identified when considering an engagement from a new or existing client. • If the firm identifies issues and decides to accept or continue the client relationship or a specific engagement, require the firm to (1) consider the applicability of ethical requirements of ET 1.110.010, *Conflicts of Interest*, such as disclosure of the relationship to the client and other appropriate parties, and (2) document the resolution of identified issues.	QC 10.28
To minimize misunderstandings regarding the nature, scope, and limitations of the services to be performed, the firm should establish policies and procedures that require obtaining an understanding with the client.	QC 10.29
The firm should establish policies and procedures for continuance of an engagement and the client relationship that address the instances where the firm subsequently obtains information that would have caused it to decline the engagement had the information been available prior to acceptance. Such policies and procedures should consider— • The professional and legal responsibilities that apply to the instances, including determining the necessity of the firm to report these situations to regulatory authorities. • The possibility of withdrawal from the engagement or from both the engagement and the client relationship.	QC 10.30

* * *

Exhibit 1-2

Requirements for Acceptance and Continuance QC Procedures under AU-C 220

Requirements	AU-C 220
The engagement partner should determine that appropriate procedures regarding the acceptance and continuance of client relationships and audit engagements have been followed and all conclusions are appropriate.	AU-C 220.14
If the engagement partner obtains information that would have caused the firm to decline the audit engagement had that information been available earlier, the partner should promptly communicate that information to the firm and take the necessary action.	AU-C 220.15
Audit documentation should include the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements.	AU-C 220.25c

* * *

Exhibit 1-3

Attestation Engagement-level QC Requirement under AT-C 105

Requirement	AT-C 105
The engagement partner should take responsibility for the overall quality on each attestation engagement, including that appropriate procedures are performed with regard to the acceptance and continuance of client relationships and engagements.	AT-C 105.33(a)

* * *

Exhibit 1-4

SSARS Engagement-level QC Requirements under AR-C 60

Requirements	AR-C 60
The engagement partner has to be satisfied that appropriate procedures were performed in accepting or continuing a SSARS client relationship or engagement, while also considering whether information is present indicating a lack of management integrity.	AR-C 60.21(d)(i)
To ensure that appropriate action is taken, the engagement partner should immediately communicate to the firm any information that would have caused the firm to decline acceptance or continuance of an engagement had that information been provided earlier.	AR-C 60.22

* * *

Summary of the Lesson

This lesson discusses the following topics:

- Evaluating firm competence and capabilities (including time and resources).
- Compliance with legal and relevant ethical requirements.

- Evaluating the integrity of the client.
- Evaluating other client and engagement considerations, including risk.
- Obtaining client agreement on engagement terms.
- Withdrawal considerations.
- Drafting the firm's quality control policies and procedures.
- Evaluating the overall adequacy of the quality control system's design.
- Monitoring compliance with the firm's acceptance and continuance policies and procedures.

FIRM COMPETENCE AND CAPABILITIES

QC 10.27 indicates that the firm will only undertake or continue relationships and engagements when it has met three requirements. The first requirement for accepting or continuing a relationship and/or engagement stipulates that the firm is competent to perform the engagement and has the capabilities, including time and resources, to do so. (The other two requirements are addressed later in this lesson.) Thus, the firm should decide if its personnel possess the competence and capabilities and have the scheduling availability to provide the desired services. It is a decision that the firm should consciously make on both new clients and engagements and recurring engagements. Just because the firm was able to successfully complete the prior year engagement, it does not necessarily mean that the same result will be repeated on the next engagement. There are many possible circumstances that may have occurred at the firm level and/or the client level that could significantly affect the performance of the next engagement. QC 10.A11 offers the following matters to consider:

- Do firm members have, or are they able to acquire before performing the engagement, the requisite industry or subject matter knowledge?
- Do firm members have the requisite experience with regulatory or reporting requirements, or are they able to acquire the necessary expertise before performing the engagement?
- Are there sufficient competent and capable firm personnel available to perform the engagement?
- If specialists are needed, are they available?
- For applicable engagements, are there individuals qualified to perform an engagement quality control review?
- Can the firm meet the reporting deadline required by the engagement?

Determining the above matters involves considering the specific requirements of the engagement and existing partner and staff profiles. Additionally, there have been instance in practice of firms accepting engagements when personnel do not have the available scheduled time to perform the engagement by the requested due date. Accepting engagements in that situation not only puts added stress on firm personnel, but can lead to lack of compliance with engagement performance requirements, which may negatively affect the firm's peer review. When considering whether the firm has the time and resources to devote to the engagement, the firm needs to consider the likelihood that the engagement could require an inordinate amount of time compared to other engagements and the available resources of the firm (for example, because the engagement is for a client in a new industry or it represents a new type of service for the firm).

Industry or Subject Matter Knowledge

The human resources QC element focuses on the general competence and capabilities of personnel. Within the context of the acceptance and continuance QC element, the focus is on whether the firm has, or is able to acquire, the specialized knowledge necessary for the specific engagement. Certain industries such as health care, financial services, technology, real estate, construction, and petroleum have unique terminology, complex transactions, and specialized accounting requirements that are not encountered in general engagements.

The *General Standards Rule* (ET 1.300.001) of the Code applies to all public accounting services and requires that members agree to perform only those professional services that the member or the firm can reasonably expect to complete with *professional competence*. While *competence* includes the ability to make sound decisions in the performance of an engagement, the most frequently assumed qualification of competence is technical proficiency. Not having the specialized knowledge about the specific industry in which the client operates at the beginning of an engagement does not force a firm to decline an engagement if it is possible to obtain that knowledge during the course of the engagement.

Methods of obtaining knowledge can include continuing education courses, self-study, and research. The firm might consider the complexity of the material to be covered and whether there are relevant training classes and materials available, as well as whether there is sufficient time to develop the desired level of expertise necessary for the engagement. Where adequate time is not available to develop the needed expertise, the only option may be to engage the services of an outside specialist.

Special Considerations—Ethics Requirements When Using Third-party Service Providers. Members who outsource client work to third-party service providers are subject to specific requirements, which are detailed in three ethics rulings.

- Before engaging the services of a third-party service provider, members should enter into a contractual agreement with the third-party service provider requiring confidentiality of client information. In addition, members should obtain reasonable assurance that the appropriate procedures are in place at the third-party service provider to prevent the unauthorized release of confidential information to others. If the accountant does not enter into a confidentiality agreement with a third-party service provider, specific client consent should be obtained before the member discloses confidential client information to the third-party service provider. (See ET 1.700.040, *Disclosing Information to a Third-Party Service Provider*.)

- When using a third-party service provider to provide professional services for a client, the accountant has a duty to inform the client, preferably in writing, of the use of such a provider prior to sharing confidential client information with that provider. If the client objects to the use of a third-party service provider, the engagement would have to be performed without using third-party service providers, or the firm should decline the engagement. (See ET 1.150.040, *Use of a Third-Party Service Provider*.)

- The accountant is responsible for all work performed, including the work performed by third-party service providers, and ensuring that the services meet the general standards and all other applicable technical standards. (See ET 1.300.040, *Use of a Third-Party Service Provider*, and ET 1.310.001, *Compliance With Standards Rule*.)

Regulatory or Reporting Requirements

For certain engagements, it may be necessary for firm staff to have a specialized background or be acquainted with additional standards beyond the audit, attestation, or preparation, compilation, and review standards. For example—

- State and local governments follow GASB (as opposed to FASB) guidance and are also subject to audits performed under *Government Auditing Standards* (the Yellow Book).

- Nonprofits and state and local governments that receive federal awards exceeding $500,000 are further subject to audits performed under the Single Audit Act.

- Employee benefit plans are subject to ERISA and DOL requirements.

- Audits of issuers (as well as certain other public business entities) are subject to the auditing standards of the Public Company Accounting Oversight Board (PCAOB) and the regulations of the SEC.

Meeting Reporting Deadlines

As part of the acceptance and continuance decision, the firm should consider whether the engagement can be completed when requested. Even if the firm has the staff with the appropriate technical background, if those resources are not available to perform and complete the engagement within the deadline specified by the client, the firm needs to decline the engagement. For example, if an engagement is needed to secure debt or satisfy debt covenants, submitting financial statements later than the stipulated date may have severe consequences for the client. It is also important that the firm understand the nature of the deadline to determine if it is arbitrary or imposed by a legal or regulatory entity. If the deadline is not imposed by a legal or regulatory entity, the firm might be able to negotiate a revised deadline compatible with availability of firm resources.

COMPLYING WITH LEGAL AND RELEVANT ETHICAL REQUIREMENTS

When deciding whether to accept or continue an engagement, the firm is required to develop policies and procedures to determine whether it can comply with the requisite legal and relevant ethical requirements of the engagement.

Legal and Regulatory Requirements

Certain engagements require a firm to comply with specific legal and regulatory requirements. Those requirements may apply as a result of the type of industry in which the client operates, or whether the client is a public entity. For example—

- FDICIA (the Federal Deposit Insurance Corporation Improvement Act of 1991) requires nonpublic banks and savings institutions with assets of $500 million or more to comply with independence standards and rules adopted by the PCAOB.

- Engagements that require the auditor to collect and examine the personal information of a client's customers, employees, or vendors may subject the accountant to federal and state privacy laws such as the Health Insurance Portability and Accountability Act (HIPAA). Also, many companies are subject to Security Breach Notification Laws, which are now in effect in almost all states.

Licensing Requirements

Before performing any professional services, firms are required to obtain (and maintain) firm license(s), including licenses in states other than where the firm's main office is located. In all states where the firm provides professional services, the firm should—

- be licensed under the same name under which it practices,

- obtain the license before any reports are issued in the state,

- consider how variations in licensing body regulations affect the firm's practice in a particular state, and

- address any restrictions that have been imposed by a licensing body.

The firm's professional employees are also required to obtain and maintain a license to practice public accounting. Each individual state board of accountancy establishes those requirements, and firms should ensure that their professionals are maintaining appropriate licenses. When a CPA performs services in more than one state, each state's requirements should be considered to ensure that the most strenuous requirements are properly met.

Relevant Ethical Requirements

Under the *Objectivity and Independence Principle* and the *Integrity and Objectivity Rule* (ET 0.300.050 and ET 1.100.001, respectively) of the Code, members in public practice are required to be independent in both fact and appearance, as well as maintain integrity and objectivity when performing professional services. Subject to mitigating factors, in cases where it appears that a firm's independence, integrity, or objectivity is likely to be impaired, the firm should decline to accept an engagement.

Conflicts of Interest. The discovery of any potential conflicts of interest should cause the firm to seriously consider whether an engagement with a new or existing client should be accepted. QC 10.28 directs that the firm's QC policies and procedures require the firm to determine if an identified potential conflict of interest should keep the firm from accepting the engagement for a new or an existing client. In the situation where issues are identified during the acceptance and continuance decision process and the firm decides to accept or continue the client relationship or specific engagement, the policies and procedures should require the firm to consider whether ethical requirements regarding conflicts of interest apply and to document how issues were resolved. When a conflict of interest situation is encountered, the ethical requirements under the *Conflicts of Interest* Interpretation (ET 1.110.010) should also be considered.

Conflicts of interest might arise in situations such as the following:

- Providing financial advice to two clients who are involved in a legal proceeding with each other at the same time and in the same matter (such as during a divorce or a partnership dissolution).
- Advising a client about investing in a business when one of the CPA's immediate family members has a financial interest in the business.
- Providing tax or personal financial planning services for several members of a family when family members have opposing interests.
- Providing financial services to a client that wants to acquire one of the firm's audit clients, and the firm has confidential information that may be relevant to the acquisition.

Conflicts of interest often relate to providing services other than those that require independence. Conflict of interest rules under the Code focus on relationships that create a perceived impairment of objectivity. Such relationships may exist with people, entities, products, or services that the practitioner is involved with. A firm should use professional judgment when making an evaluation about a conflict of interest and consider whether a reasonable and informed third party who is aware of the relevant information would conclude that a conflict of interest exists. Before a client relationship, engagement, or business relationship is accepted, the firm should take reasonable steps to identify circumstances that might create a conflict of interest, including identifying (a) the nature of the interests and relationships between the parties involved and (b) the nature of the service, including its implication for the parties. It is natural for interests, relationships, and services to change during the course of the engagement and, accordingly, the firm should remain alert to such changes in order to identify situations that might create a conflict of interest. The firm should disclose the conflict of interest to clients and other affected parties and obtain their consent, preferably in writing, to perform the professional services.

Special Considerations—Audit Engagements

AU-C 220.14 assigns responsibility to the audit engagement partner to be satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and specific audit engagements have been followed. It also requires the engagement partner to determine whether the conclusions reached regarding the acceptance and continuance of client relationships and specific engagements are appropriate. AU-C 220.25 requires those conclusions to be documented. AU-C 220.A7 indicates that information such as the following can assist the engagement partner in making that determination:

- The level of integrity of the principal owners, key management, and those charged with governance of the entity.
- The competence and capabilities of the engagement team to perform the audit engagement.
- Whether the firm and the engagement team can comply with relevant ethical requirements.
- Significant findings or issues occurring during the current or previous audit engagement and their implications for continuing the client relationship.

Special Considerations—Attestation Engagements

AT-C 105 is the umbrella standard that governs all types of attestation engagements. There are three types of attestation engagements: examinations, reviews, and agreed-upon procedures engagements. On the topic of quality control, AT-C 105.33 indicates that the engagement partner should take responsibility for the overall quality on each attestation engagement. This includes responsibility that appropriate procedures are performed with regard to the acceptance and continuance of client relationships and engagements. Other AT-C sections provide acceptance and continuance requirements that apply to the specific types of attestation engagement.

Special Considerations—SSARS Engagements

AR-C 60.21 includes the responsibilities of the SSARS engagement partner relating to engagement-level quality control. AR-C 60.21(d)(i) requires that the engagement partner be satisfied that the acceptance and continuance process for a SSARS engagement and client relationship is appropriately performed. During the process, the engagement partner is also required to consider whether information presented or discovered indicates a lack of management integrity. AR-C 60.21(d)(iii) requires that the engagement partner maintain appropriate engagement documentation. While there is no specific guidance related to documenting acceptance and continuance, this standard includes the documentation of this process. AR-C 60.A44 has the same indicators as AU-C 220.A7 that can assist the engagement partner in making that determination. AR-C 60.A45 states that if the severity of this determination causes the engagement partner to doubt the integrity of management and the proper performance of the engagement, it is inappropriate to accept the engagement.

EVALUATING THE CLIENT'S INTEGRITY

When deciding whether to accept or continue an engagement, the firm should establish policies and procedures to consider the integrity of the client. Specifically, QC 10.27 indicates that these policies and procedures should be designed to provide the firm with reasonable assurance that it does not accept or continue client relationships or engagements when the firm has determined that the client lacks integrity. Under QC 10, having information that the prospective or existing client lacks integrity would generally prevent the firm from undertaking or continuing a relationship or specific engagement. Information regarding factors for the firm to consider when evaluating a client's integrity are provided below.

Factors to Consider When Evaluating Integrity

When evaluating the integrity of the client, QC 10.A12 offers the following factors to consider:

- Both the identity and business reputation of the client's principal owners, key management, and those charged with its governance.
- Nature of operations and specific business practices of the client.
- Attitude of the client's principal owners, key management, and those charged with governance towards aggressive accounting and internal control matters.
- Inappropriate client limitation regarding the scope of work.
- Indications of the client's possible involvement in money laundering or other criminal activities.
- Reasons for the proposed appointment of the firm and dismissal of the previous firm.
- Length of the relationship with the client.

Each of these factors are discussed below.

Identity and Business Reputation of the Client. When considering the integrity of *the client*, who should be evaluated? According to QC 10.A12, *the client* includes the entity's principal owners, key management, and those charged with governance. This course suggests that *the client* includes related parties and any individuals who have more than just a passing involvement with the business, for example, spouses of owners who are active in the business ought to be included in the evaluation.

QC 10 does not define the phrase *those charged with governance*, but it seems logical to apply it as defined other applicable AICPA standards. The SASs and SSARS define *those charged with governance* as the individuals (or organizations) responsible for overseeing the entity's strategic direction and the obligations associated with its accountability, including the entity's financial reporting process. Those charged with governance may include management personnel.

The firm is generally able to determine the identity of prospective client principal owners, key members of management, and those charged with governance by interviewing the individuals who contacted the firm. The client's business reputation is based upon its actions, and its actions are generally determined by those individuals. Once those individuals are identified, the firm can follow a combination of additional interviews, research, investigation, and analysis to gather information about the business reputation of the client.

Nature of Operations and Specific Business Practices. The firm can obtain information about the nature of the prospective client's operations from various sources such as annual reports, interim financial statements, reports filed with regulators, credit reports, and tax returns. The firm needs to be concerned if the nature of operations is ambiguous, potentially illegal, or otherwise questionable. Red flags include sources and disbursements of cash flows that are not easily identifiable. Also, business practices employed by the prospective client should not differ significantly from those of other businesses in the same industry, unless such differences are the result of a technical innovation or process improvement. The process of gathering evidence of integrity is described later in this lesson.

Attitude toward Aggressive Accounting and Internal Control Matters. A prospective client's attitude about aggressive accounting positions or control over financial reporting can be determined through direct discussion with the prospective client or indirectly through discussions with predecessor auditors, predecessor accountants, and other third parties such as bankers. Reviewing financial statements (especially carefully worded notes to the financial statements) and tax returns may also provide actual evidence of an aggressive stance on an accounting position. Internal communications such as mission statements and procedures manuals, if available, may provide insight into the attitudes of owners, management, and those charged with governance with regard to internal control procedures and the approach to reporting accounting transactions.

Inappropriate Client Limitation Regarding the Scope of Work. Consideration of any limitations or restrictions the prospective client intends to place on the engagement is another factor that can provide evidence about client integrity. For instance, the timing of the fieldwork needs to be such that the firm has sufficient time to apply all necessary procedures. If there are obstacles to the firm's ability to apply all necessary procedures, the firm generally evaluates if alternative procedures can be performed to overcome the restriction. However, in the event an engagement restriction makes it impossible or impracticable to apply necessary procedures and alternative procedures are unavailable, a scope limitation exists. In such a situation, the firm needs to consider whether the prospective client is imposing inappropriate limitations on the firm's work.

Reasons for Nonreappointment of the Previous Firm. The reasons a client changes accounting firms could influence a prospective firm's decision on the desirability of accepting the client. Some of the reasons that could negatively impact the prospective firm's decision to accept the client include learning that (a) the client lacks integrity or (b) the client is changing accountants because of a dispute with the previous accounting firm about scope or financial statement presentation. It is important for the prospective firm to communicate with the previous firm to establish the facts and circumstances behind the change so that the prospective firm can better decide whether it is appropriate to accept the engagement. Discussions with the predecessor firm may reveal important information about the client's integrity, particularly if disagreements occurred between the prospective client and the predecessor firm over accounting principles or practices, financial statement disclosures, or engagement scope. The Code requires a prospective accountant to obtain the client's permission to make inquiries of the previous accountant. If a prospective client will not grant such permission, it might indicate that the prospective client is trying to hide something.

Length of the Relationship with the Client. In evaluating whether to continue a relationship with an existing client, another factor to consider is the length of the relationship, as the amount of information known about the client will increase over time. If a client relationship has existed for a long period of time, yet knowledge of that client is still limited, the firm may wish to consider whether the client has been open enough with the firm.

Conversely, the opposite situation can occur. If firm partners and staff work on the same engagement for years and develop close working relationships with a client's management, it may be difficult to maintain a sufficient level of professional skepticism about the client's activities and integrity. In such a case, a familiarity threat to independence could exist.

Gathering Evidence of Integrity

It is a best practice for the firm to consider conducting a thorough and complete screening of current and prospective clients. For small firms and acceptance of relatively small clients, cost-benefit considerations are involved in determining the extent to which the firm would ordinarily perform client screening. However, because of the importance of client integrity to the client and engagement acceptance and continuance process, this course recommends that firms consider performing thorough client screening procedures whenever feasible.

Client screening is performed for the purpose of discovering evidence of questionable behavior. Screening may include a combination of interviews, research, investigation, and analysis. The firm should consider consulting with legal counsel in certain cases prior to investigating a current or prospective client to determine if there are any federal, state, or local statutes that require permission from, or disclosure to, the prospective client.

Obtaining a critical mass of information can be difficult to do when the client is a nonpublic entity; however, there are ways to gain knowledge about nonpublic prospective clients by exploring key areas, such as those discussed in the paragraphs that follow. Also, in many cases, much of the information will be more readily available to a firm that is assessing an ongoing client relationship than to firms that are evaluating a prospective client.

In performing client screening procedures, key areas to evaluate may include the following:

- Interaction with CPAs and other professionals.
- Reputation in the community.
- Profile as a corporate citizen.
- Fiscal responsibility.
- Formal company communications.
- Openness of the client.
- Dealings with employees.

The paragraphs that follow discuss those screening procedures and refer to the prospective client; however, this guidance is also applicable to evaluating current clients when deciding whether to continue existing client relationships.

Interaction with CPAs and Other Professionals. Firms may engage in discussions with CPAs, lawyers, bankers, and other professionals in the community to make specific inquiry of professionals who have served the prospective client. In discussions with other professionals, asking questions such as the following might be helpful:

- Has the prospective client experienced a more than normal frequency in changing its tax accountants or auditors? This may be a sign of disagreements involving questionable practices that other professionals are unwilling to accept or endorse.
- Has the client been unwilling to sign engagement or representation letters?

- Has the client imposed unreasonable deadlines on prior auditors or other professionals?

- Is the client management team known for taking unreasonable business risks?

- Has the client been difficult to satisfy?

- Does the client have a propensity for litigation? Review current court dockets, including the U.S. Bankruptcy and Tax Court dockets, for ongoing litigation. A comprehensive investigation will discover how often the prospective client uses its legal counsel and in what context. A firm is wise to avoid clients who seem to solve their disagreements in court.

Reputation in the Community. A business that is well respected by the community can generally be assumed to have won that respect through honest dealings with customers and the public. Firms might consider the following in determining the client's reputation in the community:

- Visit store locations of the prospective client, if any. Is there good customer traffic? Is there community support for the business? Do conversations with customers illicit positive responses? Do the store locations demonstrate care for customers by presenting a clean appearance and providing a safe environment?

- Do suppliers and other vendors seek a business relationship with the prospective client? If the business has experienced turnover with several vendors, this may be an indicator of deeper problems.

- What is the tone of press reports? The investigative phase of the client screening process includes searches of news retrieval agencies and trade publications that might contain information on prospective clients and their management. Accessing and searching electronic archives of local newspapers will speed up the research process and may surface relevant issues to discuss with the prospective client.

- What information is available from on-line services? Some of those providers allow the firm to search for bankruptcy records, litigation history, Dun & Bradstreet reports, corporate filings, and corporate affiliations and can be performed from the office at a relatively low cost.

- Reports filed with the Better Business Bureau are a good source of information regarding the business dealings of the company. Those reports may have a degree of reliability in that a fee is charged to customers and others who wish to file a report about the business.

- Other sources of information include websites that offer opportunities for users to post comments about a business. While these comments must be evaluated on their own merit, they are, nonetheless, public opinions of individuals with first hand dealings with the prospective client.

Exhibit 1-5 provides sources of background information available to firms online.

Profile as a Corporate Citizen. How a business is involved with its community also demonstrates the character of its leadership. A business that cares about doing the right thing will likely be actively involved in the community. To determine whether a prospective client is a good corporate citizen, a firm might consider the following:

- Does the business sponsor local charitable events? If members of the firm are also involved in community events, there may already be ample sources of information within the firm to evaluate this area.

- Make inquiries of local business groups or associations, such as the local Chamber of Commerce or trade associations.

- Have any complaints been filed with state or federal agencies? What is the nature of those complaints and are the sources credible?

Exhibit 1-5

Sources of Background Information

INFORMATION SOURCE	HOW TO CONTACT
Credit Rating Services	
Dun & Bradstreet (D&B)	**www.dnb.com**
Equifax	**www.equifax.com**
Experian	**www.experian.com**
Moody's Investors Service, Inc.	**www.moodys.com**
National Association of Credit Management (NACM)	**www.nacm.org**
TransUnion	**www.transunion.com**
Online Database Services	
Access Information	**www.access-information.com**
Bloomberg	**www.bloomberg.com**
CLEAR	**clear.thomsonreuters.com**
Financial Risk Management	**www.brint.com**
Hoovers	**www.hoovers.com**
LexisNexis	**www.lexisnexis.com-en-us/home.page**
ProQuest Dialog	**www.proquest.com/products-services/proquest-dialog.html**
PublicData.com	**www.publicdata.com**
Standard & Poor's	**www.standardandpoors.com/en_US/web/guest/home**
General Business Information	
WhitePages	**www.switchboard.com**
AnyWho	**www.anywho.com**

* * *

Fiscal Responsibility. Maturity in fiscal matters demonstrates an attitude of responsibility and an ability to meet financial obligations. Businesses that are able to meet their financial obligations may be less likely to engage in inappropriate business practices. Moreover, the importance a business places on meeting its financial obligations may indicate how readily accounting and audit fees will be paid. The firm might consider the following in determining whether a prospective client exhibits fiscal responsibility:

- Even without performing an audit of a prospective client's business records, a firm may be able to get a preliminary financial picture by evaluating its creditworthiness. A prospective client's creditworthiness can often be obtained through inquiring of a commercial credit rating service such as Equifax, Experian, D&B, or Moody's.

- The physical state of the facilities may also be an indicator of how a company manages its assets, including financial assets. Facilities in obvious need of repair may be an indicator of severe cash flow issues.

- Information regarding any tax or real estate liens is publicly available. Many counties have this information available online.

- If a prospective client initially refuses to agree to a reasonable fee estimate, that may indicate future fee issues. The firm might consider collecting a retainer fee in advance of performing certain services.

Formal Company Communications. How does the business present itself to its employees, customers, and other business partners? A firm might consider the following:

- A good way to evaluate the company's tone at the top is to review formal company communications such as the mission statement, ethics policies, and customer policies. Some of those documents may be available on the company website, while others may only be available if the prospective client agrees to share them.

- Company-sponsored advertising offers another view of how the business presents itself. Advertisements can be found in local newspapers, the company website, and store locations , if any. Advertising that is too slick or promises too much may be a cause for concern.

- Internal policies over the financial process may demonstrate the company's commitment to sound accounting policies and internal control procedures. Good faith efforts to collect and communicate accurate and technically correct financial information may mean that the firm might be less likely to encounter fraud (which is not to say that the firm may be less alert to the possibility of fraud).

- Review minutes of board of directors meetings, if available, for discussions of issues that provide insight into the prospective client's integrity.

Openness of the Client. The degree of openness of the prospective client may be an indicator of general integrity. For example, a client with nothing to hide will not have anything to fear by the firm contacting customers, vendors, employees, or other third parties who have had dealings with the client. Information obtained from those discussions can be valuable in evaluating the integrity of the client. However, if the prospective client is very selective about the contacts the firm will be allowed to make, the firm needs to be aware that the client will be putting its best foot forward and will likely offer up only those contacts with glowing recommendations. In evaluating client openness, the firm might consider the following:

- If a tour of the operations is given, is the firm allowed to speak with any employees? Are there any activities that appear suspicious?

- What degree of freedom does the firm have in selecting contacts to question?

- In cases where the client is not forthcoming with information, a background investigation may be performed by an investigative services company.

Dealings with Employees. How a company deals with its employees may also reveal the measure of its integrity. Issues do not have to be resolved in the employee's favor—whether the company has acted in a fair and equitable manner can be a litmus test for integrity. Consider the following questions in determining how the company deals with its employees:

- Is there frequent turnover in management positions?

- Have any issues with employees become public? An online search of newspaper databases or a Google search may reveal any such disagreements.

- Have there been any actions filed with federal agencies, such as the Equal Employment Opportunity Commission or the Department of Labor?

- Are there any pending lawsuits, and if so, what is their nature? Review current court dockets for ongoing litigation.

- Does the company have an employee policy manual? If it is made available to the firm, are the policies reasonable and comprehensive, and do they demonstrate an expectation of integrity in the actions of employees?

- What is the company's attitude toward confidential information? Respecting the privacy of others is a facet of high integrity. Review the company's privacy policy regarding the personal information of employees, customers, and vendors.

Special Considerations—Audit Engagements

Predecessor Communications. AU-C 210, *Terms of Engagement*, includes requirements and guidance with respect to communications with a predecessor auditor before accepting an initial audit engagement, including a reaudit. This communication provides the successor auditor with information about the client and its management's integrity. Some of the inquiries the successor may make of the predecessor include:

- Are there facts that might bear on the integrity of management?
- Were there disagreements with management about accounting principles, auditing procedures, or other similar significant matters?
- Were there any communications with those charged with governance regarding fraud and noncompliance with laws and regulations by the entity?
- Were there any communications with management and those charged with governance regarding internal control matters?
- What is the predecessor's understanding of the reasons for the change in auditors?

As a prerequisite to the communication with a predecessor auditor, the successor auditor should request permission from the prospective client to make the inquiries listed above. Once permission is obtained, the prospective client instructs the predecessor to respond fully to the inquiries. If management refuses to authorize the predecessor to respond fully to the inquiries or if the predecessor provides a limited response, the successor should consider the implications before accepting the engagement. The information obtained from the predecessor should also be considered in concluding whether to accept the engagement. While an auditor may make a proposal to the client before communicating with the predecessor, the communication ought to occur before *final* acceptance of the engagement.

Management-imposed Limitation on Engagement Scope. AU-C 210.07 notes that there may be circumstances when management or those charged with governance may impose a limitation on the scope of the auditor's work. If the auditor believes that the scope limitation would result in a disclaimer of opinion on the financial statements taken as a whole, the auditor should not accept the engagement. (However, if the entity is required by law or regulation to have an audit and the scope limitation and disclaimer of opinion is acceptable under the applicable law or regulation, the auditor may, but is not required to, accept the engagement.)

Additionally, if the prospective audit client denies access to the predecessor auditor's workpapers, the firm needs to carefully consider the acceptance decision. Discussions with the predecessor auditor may reveal important information about engagement risk, particularly if disagreements occurred between the prospective client and the predecessor auditor over accounting principles or practices, financial statement disclosures, or audit scope.

Special Considerations—Attestation Engagements

When considering accepting an attestation engagement, the first hurdle to pass is that the practitioner must be independent. In addition, according to AT-C 105.23, the engagement partner should determine that appropriate acceptance and continuance procedures have been performed and that the final conclusions reached on whether to accept or continue an engagement are appropriate. To make that determination, AT-C 105.25 requires the practitioner to determine that the following preconditions are met:

- The responsible party, who is not the practitioner, takes responsibility for the subject matter.
- The subject matter is appropriate and the criteria are suitable and available to the specified users.
- The practitioner expects to be able to obtain the evidence necessary in the engagement, including unrestricted access to information and individuals within the entity.
- The practitioner will issue a written report detailing the engagement findings.

If those preconditions are not met, the practitioner should discuss the matters with the client to try and resolve any issues.

An engagement should be accepted only after the practitioner has determined that it meets all of the preconditions for attestation engagements discussed in the previous paragraph and the practitioner—

- does not have reason to believe that relevant ethical requirements, including independence, will not be met,
- believes that the persons performing the engagement will collectively have appropriate competence and capabilities, and
- has reached a common understanding with the engaging party of the engagement's terms, including the practitioner's reporting responsibilities.

If, after accepting an engagement, the practitioner discovers that not all of the preconditions are present and the situation is not resolved, the practitioner should discuss the matter with the appropriate person(s) and determine whether it can be resolved and whether it is appropriate to continue the engagement. If the matter cannot be resolved but it is appropriate to continue, the practitioner should determine the effect on the practitioner's report. See *PPC's Guide to Nontraditional Engagements* for further information on accepting an attestation engagement.

Special Considerations—SSARS Engagements

Unlike the mandatory communication required by auditing literature, under the SSARS, an accountant is not required to communicate with a predecessor accountant as a prerequisite to acceptance of an engagement. However, if the successor wishes to make inquiries of the predecessor and the client refuses, the accountant should consider the reasons for the refusal and its implications on accepting the engagement. The refusal itself does not preclude an accountant from accepting the engagement. However, the refusal may cause doubt about management's integrity or management's reliability in making available all relevant resources and information. According to AR-C 60.25, those doubts, in addition to doubt about relevant ethical requirements being able to be satisfied, provide a reasonable basis for not accepting a SSARS engagement.

According to AR-C 60.26, an accountant should make the following inquiries as a precondition for accepting any SSARS engagement to ensure the integrity of the client:

- Determine whether preliminary knowledge of engagement circumstances satisfies the ethical requirements of professional competency.
- Determine the acceptability of management's financial reporting framework used to prepare financial statements.
- Obtain management's agreement and acknowledgment that it understands its responsibilities for:
  - •• the financial reporting framework chosen for preparing financial statements.
  - •• the design, implementation, and maintenance of internal controls over the creation and fair presentation of financial statements that are free of material misstatement due to fraud or error (except when the accountant decides to accept responsibility for such internal control).
  - •• the prevention and the detection of fraud.
  - •• the client's compliance with applicable laws and regulations.
  - •• the accuracy and the completeness of client-provided documents and explanations, and other information, including significant estimates and judgments used to create the financial statements.
  - •• providing the accountant with:
    - – access to all information management has relating to the creation and the fair presentation of financial statements.

- access to any additional information requested with regard to the engagement.
- unrestricted access to personnel for inquiries relating to the engagement.

AR-C 80.08–.09 for a compilation and AR-C 90.08–.10 for a review also require the firm to obtain agreement from management that the financial statements and disclosures are prepared and presented in accordance with the selected financial reporting framework and the compilation or the review report is included in any document making reference to it. The accountant should be satisfied about all the engagement acceptance and precondition matters discussed above or discuss the matters with management or those charged with governance. The accountant should not accept the proposed engagement if any matters cannot be satisfactorily resolved.

THE EVALUATION OF OTHER CLIENT AND ENGAGEMENT CONSIDERATIONS, SUCH AS RISK

So far, this lesson has discussed the three requirements of (a) firm competency, (b) firm compliance with legal and relevant ethical requirements, and (c) client integrity as prerequisites to accepting and continuing client relationships and engagements. The firm is required by QC 10 to put policies and procedures in place to provide reasonable assurance that the firm does not undertake or continue engagements that do not meet those three requirements. This section expands upon such policies and procedures.

Timing and Scope of Clients and Engagements Subject to QC 10

QC 10.28 requires that the firm's policies and procedures for accepting and continuing client relationships and specific engagements facilitate the firm gathering all the information it considers necessary in the circumstances about a client or an engagement before—

- A new client is accepted.
- Work on a continuing engagement begins.
- A new engagement with an existing client is accepted.

QC 10.A14 further explains that making a decision about whether to continue an existing client relationship includes consideration of significant issues that have arisen during the course of the relationship with the client and the implications for how those issues affect the ongoing client relationship. As an example, the client may have begun to expand its operations into an area that needs specialized accounting knowledge, and the firm does not currently possess, and cannot immediately obtain, the necessary competence.

Evaluating the Acceptability of Existing Client Relationships. One of the major deficiencies of most acceptance and continuance QC systems is the failure to adequately evaluate the acceptability of existing clients and engagements. While some firms may be reluctant to adopt formal procedures for fear that they will be costly and time-consuming, considering whether to continue a client relationship or specific engagement is not an optional procedure. Even though some firms may view such an evaluation as a futile exercise because rarely can a firm afford to dismiss a marginally profitable client, the QC, audit, attestation, and SSARS professional literature require firms to consider the continuance decision. Additionally, due to the requirement in QC 10.27 to assess a client's integrity, the continuance decision is more than just a risk and cost-benefit analysis.

In addition to complying with the continuance evaluation requirement, an annual client and engagement evaluation provides valuable information to firm leadership and makes good business sense. One of the additional primary benefits of the evaluation is not the dismissal of clients, but the identification of problem clients and the development of strategies to mitigate the risk associated with those clients; for example, requiring down payments on fees before work commences, flexible fee arrangements, and expanded or alternative procedures to reduce risk.

Evaluating the Client List. There are two approaches to performing ongoing client and engagement evaluations. One approach is to annually reevaluate each client on the firm's client list in a meeting of all partners. To control the meeting time, partners may be asked in advance to specifically evaluate clients for which they have engagement responsibility.

Reasons that might cause the firm to consider discontinuing services include (not intended to be all-inclusive)—

- Significant changes in the client, for example, retirement of senior management, perceived integrity of management has declined, other ownership changes, nature of its business, or decline in financial stability.
- Changes in the nature or scope of the engagement, including requests for additional services the firm may not be adequately prepared to render.
- Significant changes in the composition of the firm, for example, a change in the firm's professional competence (expertise) in a particular industry.
- Significant unpaid fees that may cause an independence problem or create doubt about the collectibility of future fees.
- The existence of conditions that would have caused the rejection of a specific client or engagement had such conditions been present at the time of the initial acceptance.
- The client is in the development stage or operates in a highly specialized or regulated industry (such as a financial institution, governmental entity, or employee benefit plan) that poses undue risk to the firm.
- Engagements in which the firm has substantial doubt about the entity's ability to continue as a going concern.
- More time is needed to perform the engagement than the firm has available.
- The client has ignored prior firm recommendations, such as recommendations regarding the interpretation of accounting standards or addressing internal control deficiencies.

Evaluating the Client during the Planning Stage of Each Engagement. A second approach to ongoing client and engagement evaluation is to have the engagement team reevaluate the acceptability of the client and the specific engagement during the planning stage of each engagement. This procedure necessitates that the firm add a program step to its engagement work programs to remind the engagement team of its responsibility.

Which Approach Does This Course Recommend? Either approach to evaluating the ongoing acceptability of a client is an effective technique. Adopting both procedures (a macro review of the client list and a micro review of each engagement) can be helpful because the procedures are complementary and are not time-consuming. However, firms need to establish policies and procedures that work best for their particular clients and circumstances.

Dismissing a Current Client. Regardless of which of the approaches discussed above is used, it is a best practice for the ultimate decision to dismiss a current client to be made by firm management in coordination with the engagement partner, unless specified otherwise by professional standards or applicable legal and regulatory requirements. Dismissing a client (that is, ending the relationship) occurs before the next engagement begins. As uncomfortable as it may be to dismiss a client, doing so is occasionally necessary. Never dismissing a client is a good sign that the firm has not designed appropriate continuance policies and procedures, or is not following the procedures put in place. It is a normal part of business for a thriving CPA firm to occasionally dismiss a client.

There are a number of reasons why a client may need to be dismissed. It is not uncommon for a firm to evaluate many of the same characteristics considered during the initial acceptance decision, but obtain different answers after working with the client. Some of the reasons for dismissal include—

- Unprofitable relationship.
- Questionable integrity.
- Undisclosed or misrepresented related-party transactions.
- Management turnover.

- Poor controls or poorly maintained business records.
- Incompetent or antagonistic client staff.
- Overly demanding or constantly complaining client staff.
- Difficulty collecting the firm's fee without cause.
- Exposure to undue risk.
- Scheduling conflicts.

Documentation of Client and Engagement Evaluation. It is a best practice to document the annual evaluation in the minutes of the partners' meeting or with a memorandum. The documentation might state that all clients and engagements were evaluated, list the general factors considered, identify any steps to be taken on marginal clients, and identify any clients who will be dismissed. An example of such minutes or memoranda is presented in Exhibit 1-6. Documentation of the acceptance and continuance evaluation made at the engagement level can be made by simply completing the appropriate steps on the engagement work program.

Exhibit 1-6

Minutes or Memorandum Documenting Annual Client and Engagement Acceptability Evaluation and Monitoring

On [Insert date.] , I (we) [Names of Partners in Attendance] considered the acceptability of continuing to provide all or certain professional services to each client on the firm's client list. Among the factors considered in evaluating each client were:

- Timely payment of fees.
- The firm's relationship with client's management or owners and those charged with governance (i.e., conflicts of interest, familiarity threats, objectivity, etc.).
- Known instances of fraud, allegations of fraud, or noncompliance with laws and regulations.
- Significant changes in one or more of the following:
  - Independence relationships.
  - Perceived integrity of management.
  - Those charged with governance or key management.
  - Legal counsel or litigation status.
  - Financial condition.
  - Litigation.
  - Nature of business or industry.
  - Ability to operate as a going concern.
  - Nature or scope of engagement.
  - System of internal control or reliability of financial records.
  - Risk associated with a particular engagement.
  - The firm's professional competence (expertise).
- Aggressive accounting or tax positions taken and/or related unresolved disagreements with management.

Based on this evaluation, the following clients and/or engagements have been categorized as requiring special monitoring or expanded procedures:

[List all clients and steps to be taken to mitigate risk to the firm.]

I (We) decided to discontinue relationships with the following clients:

[List clients' names and reason for discontinuing services.]

The appropriateness of the QC system over the acceptance and continuance of clients and engagements was also considered along with the firm's compliance with the system. Results of our ongoing monitoring activities, as they relate to reviewing compliance with the acceptance and continuance system, were reviewed and evaluated. I (We) determined that both the system and the firm's compliance with the system were acceptable (except as noted below).

[List any exceptions and corrective actions here.]

Partner ____________________ Date ____________

* * *

AICPA Client Evaluation Tools. In conjunction with the AICPA's Enhancing Audit Quality (EAQ) initiative, the AICPA and the PCPS have developed two electronic client evaluation tools. The "Continuing Client Evaluation Tool" may be used to assist the firm with making an ongoing client relationship decision based on judging certain criteria and answering a series of questions. Each criteria and question are given a numerical rating by the firm as part of the evaluation process, resulting in a final quantitative score. The tool provides guidelines for making the continuance decision based on the client's quantitative score. A similar process using the "Prospective Client Evaluation Tool," can assist the firm with making a new client acceptance decision. Both tools are available at **www.aicpa.org/interestareas/privatecompaniespracticesection/qualityservicesdelivery/keepingup/pages/invigorate-the-focus.aspx**.

Consideration of Risk

The level of risk involved in performing a particular engagement is addressed in the SSAEs, SSARS, and SASs. Firms need to follow appropriate authoritative guidance regarding the consideration of risk as part of making each acceptance and continuance decision. The discussion that follows addresses various aspects of evaluating risk and common types of risk to evaluate when making the acceptance and continuance decision.

One of the key factors in reducing liability and managing risk is understanding the risk associated with a new client or engagement before accepting the work. That understanding can help the firm determine whether the client relationship will be cost-beneficial. If the client is accepted, that advance understanding of the client also helps the firm properly assess engagement risk and the related procedures that may be necessary. For instance, engagements for new ventures ordinarily have inherently higher risk than engagements with established entities. By understanding this risk, the nature, timing, and extent of procedures can typically be expanded on first-year engagements to help mitigate the additional risk (assuming those engagements are accepted).

The following paragraphs discuss some of the considerations of the client acceptance and continuance process that deal with evaluating risk resulting from the nature of an engagement and include the following:

- Evaluating risk of violating ethical requirements.
- Evaluating practice area risk.
- Evaluating industry risk.
- Evaluating engagement risk.

- Evaluating the financial reporting system and financial statements.

- Determining if scope limitations exist.

Evaluating Risk of Violating Ethical Requirements

CPAs are required to comply with very specific ethical requirements. Maintaining independence in fact and appearance can be challenging, especially in cases where the client relationship is cozy and the client has the highest integrity, operates in an ideal industry, and the engagement fits perfectly within the firm profile. Additionally, the discovery of any potential conflicts of interest should cause the firm to seriously consider whether an engagement should be accepted or continued, as discussed earlier in this lesson.

Evaluating Practice Area Risk

Will the Engagement Consume a Disproportionate Amount of Firm Resources? In deciding whether to provide a given type of service, consideration of the amount of time spent providing such services throughout the year can assist the firm in making a decision. For example, it may not be worthwhile to provide audit services if the firm will only have a small practice with a handful of audit clients. Performing audits for only a few clients may not support the time and effort it takes for the firm's audit partners and staff to remain familiar with the related professional standards. Moreover, the firm's audit personnel might not be able to receive sufficient experience from the small practice to make them technically proficient to handle difficult audit issues as they arise. Trying to provide services that significantly strain to the firm's resources may not be worth the cost on several levels.

Will the Engagement Constitute a Marginal Level of Practice? Firms may also want to avoid developing a marginal level of practice in a given area (particularly a high-risk practice area). Firms need to clearly commit to providing services in a given area (thereby developing adequate expertise) or eliminate pursuing clients desiring such services altogether. Even when dealing in areas that are not normally considered high-risk areas of practice, a firm may encounter a high level of risk if the firm does not have adequate experience. Firms that only dabble in a practice area accept higher liability risk in that area. Accordingly, exercising caution is appropriate when accepting engagements in areas where the firm's personnel have limited experience. Mitigating actions might include taking additional continuing education courses in the practice area or contracting the services of individuals outside the firm who have experience in handling that type of engagement.

Evaluating Higher Risk Practice Areas. It may come as a surprise that accountants' malpractice claim statistics historically show tax and accounting services representing the highest frequency of claims filed. However, the severity of damages per claim is higher for audit engagements and business/investment advisory services. Among the types of engagements that might present higher risk to the firm—

- Audit engagements.

- Audits of public companies (issuers).

- Prospective financial statement engagements (forecasts and projections).

While firms need not necessarily avoid offering the preceding services, firms need to be aware that such services often present higher risk. Accordingly, having the requisite competence and capabilities is especially crucial on such engagements.

<u>Audit Engagements.</u> Accountants' liability claims arising from audit engagements tend to be relatively common and also serious in terms of potential exposure. Because there is a general public perception that audited financial statements may be freely relied on in making investment and credit decisions, it is not unusual for a financial institution suffering a loan loss to seek recourse against the borrower's CPA firm. The liability exposure, combined with the ever-increasing complexity of audit and accounting standards, is so high that many firms choose not to provide audit services.

<u>Audits of Public Companies (Issuers).</u> One of the highest-risk areas of practice for CPA firms is the audit of public companies (issuers). Such audits entail not only the normal credit risks associated with audit reports of nonpublic

companies, but also the possibility of investor lawsuits each time the client's securities experience a sharp decrease in value not otherwise associated with a market movement.

Prospective Financial Statement Engagements. Because of their inherent weaknesses, prospective financial statement engagements often generate liability claims. Although many courts have adopted doctrines that tend to minimize the exposure of CPA firms issuing reports on prospective financial statements, financial forecasts and projections tend to be utilized in making significant investment and credit decisions. As a result, potential damages arising out of this type of service tend to be quite large. This, in turn, forces many firms—whose insurance might not be adequate to cover the potential liability exposure—to settle such claims.

Evaluating Industry Risk

During the client acceptance and continuance process firms need to thoroughly evaluate providing services for clients in industries that pose higher than normal levels of risk. Such industries may vary with time and economic cycles, but industries such as the following, historically tend to produce higher firm risk:

- Employee benefit plans.
- Audits performed in accordance with GAO *Government Auditing Standards.*
- Financial services companies, including banks, savings and loans, credit unions, and insurance companies.
- Broker-dealers.
- Technology companies.
- Real estate or construction companies.
- Telecommunication companies.
- Health care entities, including hospitals and nursing homes.
- Nonprofit organizations.
- Examinations of service organizations.

Companies in those industries tend to either invoke public trust or are held in suspicion as they can be quite volatile and frequently suffer high rates of business failure. Certain of those industries have specialized accounting practices and may create financial reporting and tax exposure for firms that do not fully understand these accounting practices. In addition, the financial services and real estate industries have cyclical business trends and have greater liability exposure during economic down turns. High-tech companies and companies with substantial e-commerce applications also have higher risk due to rapidly changing technology. Troubled industries can generally be identified by answering the following questions:

- Is the industry in recession?
- Has the industry been subject to increased regulatory scrutiny due to losses and insolvencies?
- Is the industry undergoing dramatic changes such as market growth or contraction, government deregulation, or intense foreign competition?
- Is the industry plagued by outdated technology that requires a significant infrastructure upgrade to remain viable or competitive?

Similar to the decision to provide services in a practice area, the decision to provide services within an industry also depends on the extent to which the CPA firm has expertise in that industry. Because performing engagements in a specialized industry requires a continuing investment in training to obtain and maintain the necessary competence, it is generally safer and more practical for a CPA firm to audit an entity in a specialized industry when the firm already has several clients in that industry or intends to expand its practice areas to include that industry. Thus, the "critical mass" of the firm's practice becomes important in determining whether a firm considers accepting clients in a given industry. Additionally, when an entity operates in an industry that meets must-select criteria for peer review purposes, the firm needs to ensure that the engagement partner possesses subject matter expertise and experience in the relevant industry.

Accordingly, when making a decision on accepting an engagement in a specialized industry, firms need to be fully aware of the need to assign more experienced staff to those engagements. Engagements with higher risk may be subject to engagement quality control review (EQCR) based on established firm criteria, which may necessitate the use of external resources to perform the EQCR, at least until such time as the firm has the requisite expertise in that industry.

Evaluating Engagement Risk

Another type of risk to consider during the acceptance and continuance process is engagement or transaction risk. Engagement risk can often be identified when the firm answers questions such as—

- During inquiries with the prospective client's management, what work is to be performed and what does the client intend to do with the work? For instance, will other people, such as bonding companies or absentee owners, rely on the firm's work? If financial statements are to be issued, are the statements intended to meet regulatory, credit, or contractual requirements?
- Will the work be used to influence investment decisions? For instance, is this engagement critical to a pending purchase or sale, obtaining business financing, or investor funding?
- Will the work be used in conjunction with a new or risky enterprise or transaction?

A thorough analysis of the engagement generally indicates the experience level and industry competence needed to properly staff the engagement. (Furthermore, the analysis might indicate that more detailed monitoring of the client is needed in the future.)

Evaluating the Financial Reporting System and Financial Statements

Before accepting the engagement, the accounting firm may also make a preliminary evaluation of the prospective client's financial reporting system to determine whether the proposed engagement is feasible. The evaluation needs to be sufficient to determine if the firm can apply required procedures on a cost-effective basis. As part of that process, the firm generally evaluates the prospective client's prior years' financial statements and available current-year financial information with the following questions in mind:

- Is there adequate documentation to support the information presented in the financial statements?
- Are the books and records in good order?
- From a preliminary review of the current financial statements, are any dramatic accounting changes evident from the prior year?
- Do comparative financial statements indicate that the entity's financial condition is deteriorating?
- Are there obvious discrepancies among the various financial statements?

While this evaluation may not reveal a well-concealed problem, it may provide evidence of potential problems or risks.

Determining If Scope Limitations Exist

Consideration needs to be given to any limitations or restrictions the prospective client intends to place on the engagement. For instance, the timing of the fieldwork needs to allow the firm sufficient time to apply all necessary procedures. If there are obstacles to the firm being able to apply all necessary procedures, the firm should evaluate if there are any alternative procedures that can be performed or applied to overcome the restriction. However, in the event an engagement restriction makes it impossible or impracticable to apply necessary procedures (when alternative procedures are unavailable), a scope limitation exists. With regard to audit engagements, certain unique requirements exist pursuant to AU-C 210. See the discussion earlier in this lesson.

SELF-STUDY QUIZ

Determine the best answer for each question below. Then check your answers against the correct answers in the following section.

1. The concept of *professional competence* includes which of the following?

   a. Making sound decisions while performing the engagement.

   b. Having the necessary specialized knowledge.

   c. Being able to meet required reporting deadlines.

   d. Not having any conflicts of interest with the client.

2. Consulting with a potential client's previous auditor or its banker would be of particular use for gathering information on which of the following topics?

   a. The nature of operations.

   b. The client's identity.

   c. Aggressive accounting positions.

   d. Limitations on the scope of work.

3. Which of the following is the most desirable potential audit client based on issues of integrity?

   a. The Silver Shoppe is having issues meeting its financial obligations.

   b. Yummy Eats has high vender turnover and little customer traffic.

   c. Baker's Dozen had a dispute with several former employees which became public knowledge.

   d. Whammy Inc. allows potential auditors to contact vendors and customers without reservation.

4. Which of the following preconditions should be met before a firm accepts a SSARS engagement?

   a. Management must use a financial reporting framework approved by the firm.

   b. The firm must determine that preliminary knowledge satisfies ethical requirements of professional competency.

   c. Management must agree not to impose any limitations on the scope of the engagement.

   d. The firm should take responsibility for the accuracy and completeness of documents.

5. Why might a firm dismiss a current client?

   a. The relationship is profitable.

   b. A reputation for integrity.

   c. Management turnover.

   d. Competent client staff.

SELF-STUDY ANSWERS

This section provides the correct answers to the self-study quiz. If you answered a question incorrectly, reread the appropriate material. **(References are in parentheses.)**

1. The concept of *professional competence* includes which of the following? **(Page 123)**

   a. Making sound decisions while performing the engagement. [This answer is correct. According to the *General Standards Rule* of the Code, members agree to perform only those professional services that the member or firm can reasonably expect to complete with *professional competence. Competence* includes the ability to make sound decisions in the performance of an engagement. It also includes technical proficiency.]

   b. Having the necessary specialized knowledge. [This answer is incorrect. Not having the specialized knowledge about the specific industry in which the client operates at the beginning of the engagement does not force a firm to decline an engagement if it is possible to obtain that knowledge during the course of the engagement. Being able to obtain the knowledge, not already having it, is part of *professional competence.*]

   c. Being able to meet required reporting deadlines. [This answer is incorrect. As part of the acceptance and continuance decision, the firm should consider whether the engagement can be completed when requested; however, this is a different concept than that of *professional competence.*]

   d. Not having any conflicts of interest with the client. [This answer is incorrect. The discovery of any potential conflicts of interest should cause the firm to seriously consider whether an engagement with a new or existing client should be expected. However, this is a different concept than that of *professional competence.*]

2. Consulting with a potential client's previous auditor or its banker would be of particular use for gathering information on which of the following topics? **(Page 127)**

   a. The nature of operations. [This answer is incorrect. This information would be more appropriately gathered using annual reports, interim financial statements, reports filed with regulators, credit reports, and tax returns.]

   b. The client's identity. [This answer is incorrect. This would be more readily determined by interviewing the individuals from the potential client who contacted the firm.]

   c. Aggressive accounting positions. [This answer is correct. A prospective client's attitude about aggressive accounting positions or control over financial reporting can be determined through direct conversation with the prospective client or indirectly through discussions with predecessor auditors, predecessor accountants, and other third parties, such as bankers.]

   d. Limitations on the scope of work. [This answer is incorrect. Consideration of any limitations or restrictions the prospective client intends to place on the engagement is another factor that can provide evidence about client integrity. However, information about this would come from the client, not predecessor accountants or third parties.]

3. Which of the following is the most desirable potential audit client based on issues of integrity? **(Page 131)**

   a. The Silver Shoppe is having issues meeting its financial obligations. [This answer is incorrect. Maturity in fiscal matters demonstrates an attitude of responsibility and an ability to meet financial obligations. Businesses that are able to meet their financial obligations may be less likely to engage in inappropriate business practices. Because the Silver Shoppe is having issues related to financial obligations, it would be a less desirable potential client, both because such issues might lead to inappropriate behavior and because it might be more difficult for the client to pay the audit fees.]

b. Yummy Eats has high vender turnover and little customer traffic. [This answer is incorrect. A business that is well respected by the community can generally be assumed to have won that respect through honest dealings with customers and the public. Good customer traffic would indicate a positive reputation, as would having suppliers and venders seeking out relationships with the client. If the business has experienced turnover with several vendors, this may be an indicator of deeper problems. As Yummy Eats is having vender and customer issues, this may be a warning sign that they are not a good potential client.]

c. Baker's Dozen had a dispute with several former employees which became public knowledge. [This answer is incorrect. How a company deals with its employees may also reveal the measure of its integrity. An online search of newspaper databases or a Google search can reveal whether any issues with employees have gone public. While the firm could find out there were positive reasons for the dispute, based on just the information provided in this scenario, Baker's Dozen is not the most desirable potential client.]

d. Whammy Inc. allows potential auditors to contact vendors and customers without reservation. [This answer is correct. The degree of openness of the prospective client may be an indicator of general integrity. For example, a client with nothing to hide will not have anything to fear by the firm contacting customers, venders, employees, or other third parties who have had dealings with the client. Information obtained from those discussions can be valuable in evaluating the integrity of the client. Therefore, because Whammy Inc. reacts with openness, assuming no red flags are raised in other areas, it would be the best potential audit client of this group.]

4. Which of the following preconditions should be met before a firm accepts a SSARS engagement? **(Page 133)**

a. Management must use a financial reporting framework approved by the firm. [This answer is incorrect. According to AR-C 60.26, the firm must determine the acceptability of management's financial reporting framework used to prepare the financial statements; however, this would be approved based on what framework the potential client uses. Use of a specific framework by the potential client would not immediately disqualify the firm from providing services.]

b. The firm must determine that preliminary knowledge satisfies ethical requirements of professional competency. [This answer is correct. Per AR-C 60-26, an accountant should make certain inquiries as a precondition for accepting any SSARS engagement. One example is to determine whether preliminary knowledge of engagement circumstances satisfies the ethical requirements of professional competency.]

c. Management must agree not to impose any limitations on the scope of the engagement. [This answer is incorrect. AU-C 210.07 notes that there may be circumstances when management or those charged with governance may impose a limitation on the scope of the auditor's work. If the auditor believes that the scope limitation would result in a disclaimer of opinion on the financial statements taken as a whole, the auditor should not accept the engagement. However, though this is an important acceptance and continuance decision, this is *not* one of the preconditions outlined in AR-C 60.26 for accepting a SSARS engagement.]

d. The firm should take responsibility for the accuracy and completeness of documents. [This answer is incorrect. One of the preconditions outlined in AR-C 60.26 is to obtain management's agreement and acknowledgement that it understands its responsibility for several items, including the accuracy and completeness of client-provided documents and explanations, and other information, including significant estimates and judgments used to create the financial statements.]

5. Why might a firm dismiss a current client? **(Page 135)**

a. The relationship is profitable. [This answer is incorrect. A firm would be more likely to dismiss a client if the relationship were unprofitable.]

b. A reputation for integrity. [This answer is incorrect. Firms want to keep clients with integrity. Client dismissal would be more likely if the client was discovered to have questionable integrity.]

c. Management turnover. [This answer is correct. There are a number of reasons why a client may need to be dismissed. One such reason is management turnover. Other possible reasons include undisclosed or misrepresented related-party transactions or poor controls or poorly maintained business records.]

d. Competent client staff. [This answer is incorrect. A firm should consider dismissing a current client if the client's staff is overly demanding, constantly complaining, incompetent, or antagonistic. Competent staff would be a reason to keep a current client.]

HOW TO OBTAIN THE CLIENT'S AGREEMENT ON THE ENGAGEMENT TERMS

QC 10.29 requires firms to establish policies and procedures to obtain an understanding with clients about the nature, scope, and limitations of services to be provided. In addition to the QC standard requirement, other professional standards contain more specific information about obtaining agreement with clients on the terms of engagements, including getting the agreement in writing. The other professional standards include the following:

- For audit engagements, AU-C 210.09–.10.
- For attestation engagements, AT-C 205.07–.09 for examinations, AT-C 210.08–.10 for reviews, and AT-C 215.12–.14 for agreed-upon procedures.
- For SSARS engagements, AR-C 70.10–.11 for financial statement preparations, AR-C 80.10–.11 for compilations, and AR-C 90.11–.12 for reviews.

The firm should decline to accept or perform the engagement if agreement with the client about the engagement terms cannot be obtained. Additionally, the Code requires an understanding to be established with the client and documented in writing before providing nonattest services to an attest client (ET 1.295.040.01). This course recommends the use of engagement letters as the preferred written method to document the agreed-upon terms of the engagement obtained with the client (or engaging party) for audits, attestations, and SSARS engagements, and the understanding obtained with the attest client before nonattest services are performed, as further explained below.

Engagement Letters

The SASs and SSARS stipulate that the firm should document the agreed-upon terms of the engagement with management (or those charged with governance) in an engagement letter or other suitable form of written agreement. Similarly, the AT-Cs require the firm to agree upon the terms of the engagement with the engaging party and specify that agreement in sufficient detail in an engagement letter or other suitable form of written agreement. Additionally, when nonattest services are provided to attest clients, ET 1.295.050 requires that the firm's understanding with the attest client about performing such nonattest services, as indicated in ET 1.295.040, be documented in writing before performing the nonattest services. Obtaining an engagement letter can be included as an acceptance and continuance procedure in the firm's QC documents.

CONSIDERATIONS FOR WITHDRAWAL

Significant Issues Discovered after the Engagement Begins

QC 10.30 requires the firm to establish policies and procedures regarding continuing an engagement and the client relationship when the firm obtains information that would have caused the firm to initially decline the engagement if such information had been known earlier. The policies and procedures for such a circumstance should consider—

- Professional and legal responsibilities that apply, including whether there is a requirement for the firm to report to regulatory authorities.
- The possibility of withdrawing from the engagement or ending the client relationship.

Withdrawing from an Engagement or Ending a Client Relationship

When drafting policies and procedures for withdrawal from an engagement or a client relationship, QC 10.A16 explains that such policies and procedures may address issues that include the following:

- Discussing with the appropriate level of client management and those charged with governance appropriate actions that the firm might take.

- When the firm's decision is to withdraw, discussing that decision and the reasons for it with the appropriate level of client management and those charged with governance.

- Considering whether there are professional, regulatory, or legal requirements to (a) remain associated with the client and the engagement, or (b) report the withdrawal together with the reasons for it to regulatory authorities.

- Documenting significant matters, consultations, conclusions, and the basis for the conclusions.

Determining When to Withdraw from an Existing Engagement. The suggested acceptance and continuance procedures discussed so far in this lesson are designed to be performed before work commences on an engagement. Even with the best possible pre-engagement procedures, situations will sometimes occur in which the firm subsequently becomes aware of facts that cause the firm to consider withdrawing from the engagement after the engagement work has begun. It is a best practice for an acceptance and continuance QC system to also provide guidance for situations that would cause a firm to withdraw. Some reasons that might cause a firm to withdraw from an engagement are provided beginning in the "Evaluating the Client List" paragraph earlier in this lesson. The decision to withdraw may depend on whether the identified risks call into question the integrity of management and whether management or others with oversight are diligent and cooperative in investigating the situation and taking appropriate action. Professional standards dictate withdrawal from an engagement when certain situations arise. See the discussion of such situations for audit, attestation, and SSARS engagements provided later in this lesson.

Responsibility for Approving the Decision to Withdraw. The managing partner is generally responsible for deciding when to withdraw from an engagement. A client may contend that the act of withdrawing from an engagement-in-process is a breach of contract. Such a contention could subject the firm to possible legal action by the client or stockholders of the client. (As a result, firms need to consider consulting legal counsel prior to withdrawing from an engagement.) The suggested audit and examination engagement letters in PPC Guides contain the following sentence that informs the client that the firm has the right to withdraw:

> If, for any reason, we are unable to complete the audit (or examination) or are unable to form or have not formed an opinion, we may decline to express an opinion or withdraw from this engagement.

In an attestation review engagement, the suggested engagement letters in PPC Guides contain the following sentence that informs the client that the firm has the right to withdraw:

> If, for any reason, we are unable to complete the review or are unable to form or have not formed a conclusion, we may withdraw from this engagement.

In an agreed-upon procedures engagement, the suggested engagement letters in PPC Guides contain the following sentence that informs the client that the firm has the right to withdraw:

> If, for any reason, we are unable to complete any of the procedures, we will describe in our report any restrictions on the performance of the procedures, or not issue a report and withdraw from this engagement.

In a compilation or review engagement, the suggested engagement letters in PPC Guides contain the following sentence that informs the client that the firm has the right to withdraw:

> If, for any reason, we are unable to complete the review (or compilation) of your financial statements, we will not issue a report on such statements as a result of this engagement.

Documenting a Withdrawal. Any serious consideration to withdraw from an engagement would generally prompt significant discussion and major consultation among the partners of the firm. QC 10 requires that major consultations be documented and filed in the engagement workpapers. Although the QC standard only suggests that policies and procedures for withdrawing from an engagement or client relationship include appropriate documentation, it seems likely that any decision to withdraw from an engagement would be subject to those same consultation documentation procedures.

Communicating the Decision to Withdraw or Discontinue Services. A decision to withdraw or discontinue services is a serious matter and, consequently, communication of this decision (especially to the client) needs to be carefully considered. In most cases, it is a best practice for the communication to be in writing. PPC's audit and accounting guides include a form for drafting a resignation letter. In many cases, the firm may need to contact legal counsel to determine the most appropriate method of making this communication. It is a good idea for the QC system to include a procedure stating that the communication to the client of a decision to withdraw from an engagement or discontinue a relationship would ordinarily be the responsibility of the managing partner. In the same procedure, the firm can mention how the communication is to be made to staff.

Special Considerations—Audit Engagements. The decision to withdraw from any engagement is usually made after the engagement work has begun since the reasons for withdrawal often include lack of sufficient accounting records, lack of client cooperation, and/or client refusal to accept a modified report. In contrast, continuation and acceptance decisions are usually made before the work commences. The auditing standards requirements related to withdrawal from an engagement include—

- AU-C 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, requires the auditor to evaluate whether to modify the auditor's opinion or withdraw from the engagement if an objective in a relevant AU-C section cannot be met.

- AU-C 210, *Terms of Engagement*, requires the auditor to withdraw from the engagement in the situation where management requests a change in the terms of the audit engagement, but the auditor determines there is no justification for such a change, and management will not permit the auditor to continue the original engagement.

- AU-C 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, requires the auditor to withdraw from the audit engagement if an independence threat is identified and cannot be eliminated or reduced by applying appropriate safeguards.

- AU-C 240, *Consideration of Fraud in a Financial Statement Audit*, requires the auditor to consider withdrawing from the engagement if suspected or identified fraud is uncovered and the auditor questions his or her ability to continue performing the audit.

- AU-C 250, *Consideration of Laws and Regulations in an Audit of the Financial Statements*, indicates that the auditor may withdraw from the engagement if management or those charged with governance refuse to accept a modified opinion.

- AU-C 510, *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements*, indicates that the auditor should consider whether to withdraw from the engagement if management refuses to inform the predecessor auditor that the prior period financial statements may need revision, or if the auditor is not satisfied with the resolution of the matter.

- AU-C 580, *Written Representations*, requires the auditor to disclaim an opinion or withdraw from the engagement if (a) the auditor believes that sufficient doubt exists about management's integrity such that certain written representations are not reliable, or (b) management will not provide certain written representations.

- AU-C 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, requires—

  - The auditor of the group financial statements to withdraw from the engagement (or not accept a new engagement) if the group audit partner determines that due to restrictions imposed by group management, it will not be possible for the group audit team to obtain sufficient appropriate audit evidence that would result in a disclaimer of opinion on the group financial statements.

  - The group engagement team to (a) consider advising the component auditor not to issue the auditor's report on the financial statements of the component and (b) whether to withdraw from the engagement, when group management will not communicate to component management any matter that the group engagement team believes may be significant to the financial statements of the component and of which component management may not be aware.

- AU-C 705, *Modifications to the Opinion in the Independent Auditor's Report*, requires the auditor to disclaim an opinion or withdraw from the audit if the auditor is unable to obtain sufficient appropriate audit evidence due to a management-imposed limitation and the auditor determines that the limitation may result in both a material and pervasive effect on the financial statements.

- AU-C 720, *Other Information in Documents Containing Audited Financial Statements*, requires the auditor to (a) include an other-matter paragraph in the auditor's report, (b) withhold the auditor's report, or (c) withdraw from the engagement when the auditor identifies a material inconsistency prior to the report release date that requires revision of the other information and management refuses to make the revision.

- AU-C 725, *Supplementary Information in Relation to the Financial Statements as a Whole*, indicates that the auditor may not express an opinion on supplementary information, or may withdraw from the engagement to report on supplementary information, when the auditor's report on the audited financial statements contains an adverse opinion or disclaims an opinion.

- AU-C 810, *Engagements to Report on Summary Financial Statements*, states that the auditor should withdraw from the engagement to report on summary financial statements when the auditor's report on the audited financial statements contains an adverse opinion or disclaims an opinion.

- AU-C 930, *Interim Financial Information*, requires the auditor to—

  - Withdraw from the engagement if management will not provide certain written representations.

  - Consider whether to withdraw from the review engagement, and if applicable, from serving as the entity's auditor if those charged with governance do not respond appropriately to the auditor's communication regarding matters affecting the completion of the review within a reasonable period of time.

  - Withdraw from the review engagement and provide no further services related to such interim financial information if the auditor believes that modification of the review report is not sufficient to address the deficiencies in the information.

  - Determine the appropriate action, including whether to withdraw from the engagement to audit the annual financial statements, if the auditor has issued a modified review report regarding a departure from U.S. GAAP and management issues the interim financial information without including the auditor's report.

- AU-C 940, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*, indicates that the auditor should withdraw from the audit engagement to perform an audit of internal control over financial reporting (ICFR) that is integrated with an audit of financial statements when management does not provide a written assessment about the effectiveness of ICFR.

AU-C 220. In the performance of an audit engagement, AU-C 220.15 places responsibility on the engagement partner when he or she obtains information that would have caused the firm to decline the engagement had such information been known initially. The engagement partner is required to promptly communicate such information to the firm so that the firm and the engagement partner can take the necessary action.

AU-C 220 also provides considerations specific to governmental entities. The standard explains that for some governmental entities, auditors may not be allowed to decline or withdraw from the engagement where the auditor's appointment was made in accordance with law or regulation. As a result, some of the requirements and considerations discussed in AU-C 220 related to acceptance and continuance may not be relevant to those entities. However, the information gathered as a result of the process is generally beneficial in planning the audit, performing risk assessments, and carrying out reporting responsibilities.

Special Considerations—Attestation Engagements. SSAE No. 18 requires the practitioner to withdraw from an attest engagement in the following circumstances:

- Examination (AT-C 205) and review (AT-C 210) engagements:
  - The engaging party is the responsible party and does not provide a written assertion (AT-C 205.82–.83; AT-C 210.59).
  - The engaging party is not the responsible party and does not provide an assertion or other requested representations either in writing or orally (AT-C 205.56b, AT-C 205.A66; AT-C 210.39b, AT-C 210.A49).
  - The engaging party is the responsible party and does not provide the requested written representations, their representations are not considered to be reliable, or there is substantial doubt about their competence or integrity (AT-C 205.55c, AT-C 205.A64; AT-C 210.38c).
  - Sufficient appropriate evidence is unable to be obtained (AT-C 205.70, AT-C 205.A109; AT-C 210.58).
  - Fraud or suspected fraud or noncompliance with laws and regulations affecting the subject matter is identified (AT-C 205.33, AT-C 205.A29; AT-C 210.24, AT-C 210.A31).
  - The responsible party does not disclose a subsequent event that is necessary to prevent users from being misled (AT-C 205.48, AT-C 205.A56; AT-C 210.31, AT-C 210.A40).
  - Other information in a client-prepared document containing the report is materially misstated or inconsistent with the report and the client does not revise the information (AT-C 205.57, AT-C 205.A67; AT-C 210.40, AT-C 210.A40).
  - In a review engagement, when the effects of a matter are material and pervasive (AT-C 210.53).
- Agreed-upon procedure engagements:
  - The engaging party is not the responsible party and does not provide the requested representations either in writing or orally (AT-C 215.32, AT-C 215.A33).
  - The engaging party is the responsible party and does not provide the requested written representations, their representations are not considered to be reliable, or there is substantial doubt about their competence or integrity (AT-C 215.31, AT-C 215.A31).
  - When restrictions are imposed on the performance of the procedures and agreement from the specified parties cannot be obtained for modifying the procedures (AT-C 215.37).

Special Considerations—SSARS Engagements. AR-C 60.22 requires the engagement partner to inform the firm promptly of any information received after the acceptance or continuance of a SSARS engagement that would have caused the firm to decline the engagement had the information been known earlier. Informing the firm aids in determining the appropriate action to be taken, including the possibility of engagement withdrawal. While AR-C 60 provides no general guidance in regard to withdrawal requirements under the SSARS, an accountant is required to withdraw from a SSARS engagement in any of the following circumstances:

- In a preparation engagement, the accountant is unable to state that no assurance on the financial statements is provided (AR-C 70.14).
- The client fails to provide requested information (AR-C 80.16a).
- The compiled financial statements contain departures from the selected financial reporting framework that the client will not correct in the financial statements or disclose in the notes (AR-C 80.16b).
- In a review engagement, independence is impaired (AR-C 90.07).

- In a review engagement, there have been substantial limitations in the scope of the engagement, particularly when management does not provide a client representation letter or management's integrity weakens the reliability of the client representation letter (AR-C 90.37).

- The reviewed financial statements are materially misstated due to fraud or noncompliance with laws and regulations (AR-C 90.51).

- The modification of the standard report on the compiled or reviewed financial statements does not adequately identify the deficiencies in the financial statements as a whole (AR-C 80.32; AR-C 90.59).

In addition to the items listed above, the accountant should consider withdrawing if any of the following conditions exist:

- The accountant does not have and cannot obtain sufficient knowledge of the client's business or industry and significant accounting policies (AR-C 80.12 and AR-C 90.14–.16).

- The client refuses, or is unable, to provide additional or revised information when the accountant has become aware that information supplied is incorrect, incomplete, or otherwise unsatisfactory (AR-C 80.14 and AR-C 90.29).

- In a compilation engagement, disclosures were omitted with an intent to mislead (AR-C 80.26).

DRAFTING QC POLICIES AND PROCEDURES

AICPA QC and Peer Review Materials

AICPA Practice Aid. The AICPA suggests use of its *Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting And Auditing Practice* (the AICPA Practice Aid) as a means to help practitioners develop the policies and procedures that comprise a firm's system of quality control. The AICPA Practice Aid includes illustrative policies and procedures, as well as tips, warnings, and reminders that firms can use to implement the policies and procedures. After reviewing authoritative literature, the illustrative examples found in the AICPA Practice Aid for designing the acceptance and continuance element of the quality control system can be considered.

Exhibit 1-7 is based on a section from the illustrative example quality control policies and procedures included in the AICPA Practice Aid for small and medium-sized firms. This section contains example policy statements, followed by example procedures that can be used in designing and documenting a firm's acceptance and continuance quality control system. Example policies are in bold type, example procedures are in regular type, and potential suggested descriptions are in italics.

Exhibit 1-7

AICPA Illustrative Policies and Procedures for Acceptance and Continuance of Client Relationships and Specific Engagements

1. **The firm considers the risk associated with providing professional services in particular circumstances, including evaluating factors that have a bearing on management's integrity. The firm only accepts or continues engagements and client relationships when it concludes that the risk is at an acceptable level. (See paragraph .28 of QC section 10.)**

    - The firm informs personnel of the firm's policies and procedures for accepting and continuing clients, through discussion or distribution of the firm's policies and procedures manual, and informing professional personnel that they are expected to be familiar with the firm's policies and procedures for the acceptance and continuance of clients, including who in the firm is authorized to accept engagements on behalf of the firm. Such policies and procedures state that the firm's clients should not present undue risks to the firm, including damage to the firm's reputation.

    - The firm communicates with the predecessor auditor as required, and considers communicating with the predecessor accountant when recommended, by professional standards. This communication includes inquiries regarding the nature of any disagreements and whether there is evidence of opinion-shopping.

- The firm obtains and evaluates relevant information before accepting or continuing any client, such as the following:
  - The nature and purpose of the services to be provided and management's understanding thereof.
  - The identity of the client's principal owners, key management, related parties, and those charged with its governance.
  - The nature of the client's operations, including its business practices, from sources such as annual reports, interim financial statements, reports to and from regulators, income tax returns, and credit reports.
  - Information obtained from inquiries of third parties about the client, its principal owners, key management, and those charged with governance that may have a bearing on evaluating the client. Examples of such third parties are bankers, factors, legal counsel, credit services, investment bankers, underwriters, and other members of the financial or business community who may have applicable knowledge.
  - Information, from discussion with the client and inquiries of others, concerning the attitude of the client's principal owners, key management, and those charged with its governance toward such matters as aggressive interpretation of accounting standards, compliance with laws and regulations, and internal control over financial reporting.
- The firm conducts a background check of the business, its officers, and the person(s) in question by using resources available on the Internet and evaluates the information obtained regarding management's integrity. An investigative firm is used when the firm is unable to obtain sufficient information about the prospective client after completing the previously listed steps, or when the firm becomes aware that there is an indication that management or someone affiliated with the prospective client may be less than reputable.
- The firm evaluates the risk of providing services to significant clients or to other clients for which the firm's objectivity or the appearance of independence may be impaired. The firm takes appropriate safeguards, if necessary, or if safeguards cannot reduce the threat to objectivity and independence to an acceptably low level, the firm does not accept the engagement.
- The firm considers the timing of the acceptance of the engagement and how that affects the firm's ability to perform all procedures necessary for the engagement (for example, inventory observation, both beginning and ending).

2. **The firm evaluates whether the engagement can be completed with professional competence; undertakes only those engagements for which the firm has the capabilities, resources, and professional competence to complete; and evaluates, at the end of specific periods or upon occurrence of certain events, whether the relationship should be continued. (See paragraph .27 of QC section 10.)**

   - If the engagement is for a level of service that the firm is not currently providing (for example, reviews or audits), the firm considers the implications for obtaining the necessary competency and the implications for Peer Review.

- The firm defines high-risk engagements based on the characteristics of the firm. The firm considers the following criteria in determining whether the engagement is high-risk *[list criteria, such as the following]*:
  - *Whether the client is in a specialized industry—that is, an industry for which there is an AICPA Audit and Accounting Guide, or the engagement is subject to governmental auditing standards—and the extent of the firm's experience in this area.*
  - *New industry for the firm.*
  - *New or specialized accounting pronouncements apply to the client.*
  - *New professional standards apply to the firm relating to the engagements.*
  - *Engagements that require an inordinate amount of time to complete relative to the available resources of the firm.*
  - *Conditions such as these exist at the entity:*
    - *Aggressive earnings management.*
    - *Unreliable processes for developing accounting estimates, or questionable estimates by management.*
    - *Questions regarding the entity's ability to continue as a going concern.*
    - *The entity is in the development stage.*
- The firm accepts engagements that meet the firm's criteria as high-risk only when the firm has, or is willing to make, the investment to acquire the necessary competency. The firm acknowledges that accepting a high-risk engagement entails assigning more experienced staff, may necessitate the use of external resources, and requires that an EQCR be performed.
- The firm evaluates whether the firm (or practice office) has, or can reasonably expect to obtain, the knowledge and expertise necessary to perform the engagement, including relevant regulatory or reporting requirements.
- The firm determines that the following are in place before accepting an engagement:
  - Sufficient personnel with the necessary capabilities and competence. This includes determining that personnel have sufficient knowledge and experience for specialized industries and the firm has sufficient technical resources available to engagement personnel, including Audit and Accounting Guides, and when necessary has arranged for personnel to receive appropriate CPE and training.
  - Whether specialists will be needed and, if so, will be available (through, for example, the resources of another practice office or alternative source).
  - Individuals meeting the criteria and eligibility requirements to perform an EQCR are available, when needed—for example, for engagements that meet the firm's definition of high-risk.
  - The firm is able to complete the engagement within the reporting deadline.
- The firm obtains relevant information to determine whether the relationship should be continued and the firm evaluates the client continuance decision at least annually *[insert timing—for example, a preliminary decision at the end of the current year engagement for (every client or high-risk clients) as part of finalizing the current year engagement and a final evaluation before the engagement letter is sent for the next engagement]*.

- The following are conditions that the firm considers in evaluating whether to continue an engagement or client relationship *[describe conditions, such as the following]*:
  - *Conditions such as these exist at the entity:*
    - *Aggressive earnings management.*
    - *Unreliable processes for developing accounting estimates, or questionable estimates by management.*
    - *Questions regarding the entity's ability to continue as a going concern.*
  - *The entity is in the development stage.*
  - *The client is delinquent in paying fees. (This may also affect the firm's independence.)*
  - *The firm is unable to meet the client's deadlines.*
  - *The services required have grown beyond the firm's ability to deliver (scope creep).*
  - *The firm is no longer willing to make the investment required to maintain competency.*
  - *The firm is unable to obtain the necessary resources to carry out the engagement, such as a person to perform an EQCR or replace the loss of key personnel.*
  - *Internal or external inspections have indicated deficiencies in the execution of the engagement (or similar engagements) and the firm is unable to mitigate the deficiencies.*
  - *Partner rotation is required by law or regulation for the engagement under consideration.*
  - *The client has ignored prior recommendations, such as those that address deficiencies in internal control.*
- When triggering events occur, the firm reevaluates the decision to accept or continue an engagement or client relationship.
- *The following are examples of such triggering events:*
  - *Significant changes in the client, such as a major change in ownership, senior client personnel, directors, advisers, the nature of the business, or its financial stability.*
  - *Changes in the nature or scope of the engagement, such as—*
    - *requests for additional services;*
    - *a request to step down from an audit to a review engagement, or*
    - *an initial public offering.*
  - *The decision to discontinue services to clients in a particular industry.*
- When making the decision, the firm evaluates the information obtained regarding acceptance or continuance of the client or engagement by doing the following:
  - The engagement partner assesses the information obtained about the client or the specific engagement, including information about the significance of the client to the firm [*using the AICPA PCPS Client Acceptance Evaluation Tool or Client Continuance Evaluation Tool*].

    - The engagement partner makes a recommendation about whether to accept or continue the engagement, or the client relationship, and submits the recommendation with supporting documentation to the managing partner (of the practice office or of the firm) for approval.

- The recommendation made by the engagement partner is reviewed and approved by *[specify, for example, the partner responsible for the quality control function or the managing partner, or in certain defined circumstances, such as high-risk engagements, both]*. If the recommendation to accept a client or continue a client relationship is not approved, the managing partner and the other partners discuss why not.

- When the firm becomes aware of information that would have caused the firm to decline the engagement if the information had been available earlier, the firm considers the professional and legal responsibilities that apply to the circumstances, including whether there is a requirement for the firm to report to regulatory authorities, and the firm considers whether to withdraw from the engagement or from the client relationship.

- The engagement partner documents evidence of consideration and approval of engagement acceptance (or continuance) in the planning section of the engagement documentation.

3. **The firm obtains an understanding with the client regarding the services to be performed. (See paragraph .29 of QC section 10.)**

    - The firm prepares a written engagement letter for each engagement, documenting the understanding with the client regarding the nature, scope, and limitations of the services to be performed. The firm obtains the client's signature on that letter before significant resources are committed to the engagement.

    - If the nature or scope of the engagement changes, the firm documents the change in an addendum to the engagement letter that is sent to the client.

4. **The firm has established procedures on withdrawal from an engagement or from both the engagement and the client relationship, as follows: (See paragraph .30 of QC section 10.)**

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

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

    - The firm considers the implications for previous engagements with this client, including the need to withdraw previously issued reports.

5. **The firm documents how issues relating to acceptance or continuance of client relationships were resolved.**

    - The firm documents, in a memorandum to the engagement files, significant issues, consultations, conclusions, and the basis for the conclusions relating to acceptance or continuance of client relationships and specific engagements.

* * *

While the AICPA's illustrative policies and procedures may provide a logical starting point for designing the acceptance and continuance quality control system, careful consideration of the firm's needs should be made before adopting them. Firms may find that the example policies and procedures do not fully meet their firm's particular needs. In fact, introductory information in the AICPA Practice Aid states that firms *may consider* establishing and implementing the illustrated policies and procedures. They are not meant to be all-inclusive, and firms are not limited to using only them. Not all of the illustrative policies and procedures will be applicable to every firm; any nonrelevant policies and procedures need to be eliminated, while other policies and procedures may need to be added. A firm's documented quality control system needs to be tailored for the policies and procedures that are appropriate for the particular firm.

AICPA *Peer Review Program Manual*. The AICPA *Peer Review Program Manual* (PRPM) provides a questionnaire that the peer reviewer completes during the planning phase of the review to evaluate the design of the firm's quality control policies and procedures. Section 4600 of the PRPM presents the questionnaire for firms with two or more personnel. Section 4500 of the PRPM provides the questionnaire for a sole practitioner with no personnel. (See section for a discussion of how QC 10 defines the term *personnel*.) It is a best practice for practitioners involved in designing a QC system for acceptance and continuance of client relationships and specific engagements to read the PRPM quality control policies and procedures questionnaire for their firm size. The AICPA also recommends that firms review these questionnaires as doing so may indicate the need for changes to the firm's written quality control policies and procedures. The questionnaires are available on the AICPA's Enhancing Audit Quality Initiative resources web page at **www.aicpa.org/interestareas/privatecompaniespracticesection/qualityservicesdelivery/keepingup/pages/invigorate-the-focus.aspx#quality**, beneath the "Quality Control & Peer Review" heading. Access to these questionnaires is restricted to AICPA members.

The size and other unique characteristics of each firm will dictate the quality control needs of a given firm and, therefore, not all questions in the PRPM questionnaires apply to every firm. Also, there is almost always an alternative procedure that is equally acceptable for a given firm. However, by considering the information in the PRPM when designing or revising its QC system, the firm can obtain a general understanding of what is suggested by the AICPA for the acceptance and continuance elements, which may be helpful when drafting the firm's policies and procedures.

Developing Acceptance and Continuance Policies and Procedures

Quality control policies are designed to achieve the overall objectives of the QC system and the specific objectives of the individual QC elements. Quality control procedures are designed to provide the actions necessary to implement and monitor compliance with the stated policies. Factors such as the following may impact the QC policies and procedures for a given firm:

- Size of the firm.
- Number of firm locations.
- Operating characteristics of the firm.
- Knowledge and experience of firm personnel.
- Nature and complexity of the firm's practice, including whether it is part of a network.

There is more than one way to develop a firm's quality control policies and procedures. For example, this course develops one policy statement for each QC element and then designs appropriate procedures for each element that implements that one policy. Alternatively, the AICPA Practice Aid provides illustrative policies and procedures that include multiple policy statements for each QC element, with procedures related to each policy. Firms can choose an approach in developing QC policies and procedures that meets the unique needs and desires of the firm.

The Firm's Quality Control Procedures

Once overall policy statements are formulated, the next step is to design the procedures needed to implement and monitor the policies. It is important for firms to design procedures that can be easily monitored by the firm and ultimately be assessed by a practice monitoring unit. Elaborate documentation is not necessarily required; instead, it should be based on the firm's size, structure, and nature of the firm's practice. Documentation should provide sufficient evidence that the quality control policies and procedures were followed. Again, a good starting point is to refer to the AICPA illustrative procedures reproduced at Exhibit 1-7.

Adopt a Standardized Checklist for Accepting a New Client. Most firms have found that an easy method for evaluating a new client is to adopt a standard acceptance checklist. Such a checklist can easily be formulated from the firm's acceptance and continuance policies and procedures. Additionally, various PPC audit, attestation, review, compilation, and other engagement guides include illustrative engagement acceptance and continuance forms designed for that purpose. Alternatively, the AICPA's client evaluation tools, discussed earlier in this lesson, may be used to assist the firm with making an initial (or continuing) client and engagement decision.

CONSIDERATIONS FOR EVALUATING THE OVERALL ADEQUACY OF THE QC SYSTEM'S DESIGN

The ideas, recommendations, and suggestions relating to acceptance and continuance put forward by this course can allow the firm to design a practical quality control system that meets its needs. The ultimate responsibility for the effectiveness of the system is, of course, in the firm's hands.

It may be helpful for the firm to consider examples of acceptance and continuance matters noted in peer reviews. Exhibit 1-8 provides examples of the significant matters noted in previous years' peer reviews.

Exhibit 1-8

Acceptance and Continuance Matters Noted in Peer Reviews

- Lack of formal policies or inadequate procedures for acceptance and continuance.
- Acceptance of engagement when the firm does not have the competence to perform the service and does not obtain the necessary knowledge before the engagement begins.
- Acceptance decisions are not adequately documented in accordance with standards.
- Continuance decisions are not reevaluated annually.
- Failure to communicate and/or document communication of a client's understanding of all services provided.
- Failure to communicate and/or document communication with predecessor auditors.
- Failure to obtain a license in all states where engagements were accepted.
- Quality control policies and procedures do not identify procedures to be followed when an existing client requests the firm to provide new services.

*   *   *

MONITORING COMPLIANCE WITH THE POLICIES AND PROCEDURES

The firm should review, on an ongoing basis, its client and engagement acceptance and continuance policies and procedures to determine if they continue to be appropriate for the firm. This review and assessment is normally accomplished in coordination with the monitoring phase of the firm's quality control system. Based on this review and assessment, the firm's policies and procedures should be revised as appropriate.

SELF-STUDY QUIZ

Determine the best answer for each question below. Then check your answers against the correct answers in the following section.

6. What professional guidance generally requires firms to establish procedures that allow them to come to an understanding with new and continuing clients about the nature, scope, and limitations of any services the firm will provide?

   a. AR-C 70.

   b. AT-C 205.

   c. AU-C 210.

   d. QC 10.29.

7. Which of the following is a special consideration when withdrawing from an audit engagement?

   a. Preparing documentation for why the firm stayed in an engagement after management requested an unjustified change in the terms of the engagement.

   b. Withdrawing from the engagement when the responsible party is the engaging party and that party did not provide a written assertion.

   c. Expressing an opinion on supplementary information after withdrawing from the engagement on the financial statements.

   d. Withdrawing from the engagement if the client refuses to accepted a modified opinion on the financial statements.

8. Which of the following example QC procedures would help a firm meet the following policy statement in its QC system:

   > The firm evaluates whether the engagement can be completed with professional competence; undertakes only those engagements for which the firm has capabilities, resources, and professional competence to complete; and evaluates, at the end of specific periods or upon occurrence of certain events, whether the relationship should be continued.

   a. The firm considers the timing of the acceptance of the engagement and how that affects the firm's ability to perform all procedures necessary for the engagement (for example, inventory observation, both beginning and ending).

   b. If the nature or scope of the engagement changes, the firm documents the change in an addendum to the engagement letter that is sent to the client.

   c. The firm evaluates whether the firm (or practice office) has, or can reasonably expect to obtain, the knowledge and expertise necessary to perform the engagement, including relevant regulatory or reporting requirements.

   d. The firm considers the implications for previous engagements with the client, including the need to withdraw previously issued reports.

9. Which of the following is a common matter noted in peer reviews related to acceptance and continuance?

   a. Too many formal policies or procedures about acceptance and continuance matters.

   b. Not evaluating continuance decisions.

   c. Documentation of the firm's communication with predecessor auditors.

   d. Obtaining licenses in multiple states.

SELF-STUDY ANSWERS

This section provides the correct answers to the self-study quiz. If you answered a question incorrectly, reread the appropriate material. **(References are in parentheses.)**

6. What professional guidance generally requires firms to establish procedures that allow them to come to an understanding with new and continuing clients about the nature, scope, and limitations of any services the firm will provide? **(Page 147)**

    a. AR-C 70. [This answer is incorrect. AR-C 70.10–.11 contains more specific guidance for financial statement preparation engagements, not the general requirement described above.]

    b. AT-C 205. [This answer is incorrect. AT-C 210.07–.09 contains guidance specifically targeted at examination engagements, not general requirements that apply to different types of engagements.]

    c. AU-C 210. [This answer is incorrect. AU-C 210.09–.10 discusses audit engagements specifically; it does not provide general requirements for multiple types of engagements as described above.]

    d. QC 10.29. [This answer is correct. QC 10.29 requires firms to establish policies and procedures to obtain an understanding with clients about the nature, scope, and limitations of services to be provided. In addition to the QC standard's more general requirement, other professional standards contain more specific information about obtaining agreement with clients on the terms of engagements, including getting the agreement in writing. Therefore, firms will need to consult both QC 10.29 and the professional guidance relevant to the specific type of engagement being performed to ensure that all requirements are met.]

7. Which of the following is a special consideration when withdrawing from an audit engagement? **(Page 149)**

    a. Preparing documentation for why the firm stayed in an engagement after management requested an unjustified change in the terms of the engagement. [This answer is incorrect. AU-C 210, *Terms of the Engagement,* requires the auditor to withdraw from the engagement in the situation where management requests a change in the terms of the audit engagement, but the auditor determines there is no justification for such a change, and management will not permit the auditor to continue the original engagement.]

    b. Withdrawing from the engagement when the responsible party is the engaging party and that party did not provide a written assertion. [This answer is incorrect. AT-C 205.82–.83 and AT-C 210.59 require the practitioner to withdraw from an attestation engagement (i.e., examination and review engagements) when the engaging party is the responsible party and does not provide a written assertion. However, this guidance applies to attestation engagements, not audit engagements.]

    c. Expressing an opinion on supplementary information after withdrawing from the engagement on the financial statements. [This answer is incorrect. AU-C 725, *Supplementary Information in Relation to the Financial Statements as a Whole,* indicates that the auditor may *not* express an opinion on supplementary information, or may withdraw from the engagement to report on supplementary information, when the auditor's report on the audited financial statements contains an adverse opinion or disclaims an opinion.]

    d. Withdrawing from the engagement if the client refuses to accepted a modified opinion on the financial statements. [This answer is correct. According to AU-C 250, *Consideration of Laws and Regulations in an Audit of the Financial Statements,* the auditor may withdraw from the engagement if management or those charged with governance refuse to accept a modified opinion.]

8. Which of the following example QC procedures would help a firm meet the following policy statement in its QC system: **(Page 152)**

    > The firm evaluates whether the engagement can be completed with professional competence; undertakes only those engagements for which the firm has capabilities, resources, and professional competence to complete; and evaluates, at the end of specific periods or upon occurrence of certain events, whether the relationship should be continued.

    a. The firm considers the timing of the acceptance of the engagement and how that affects the firm's ability to perform all procedures necessary for the engagement (for example, inventory observation, both beginning and ending). [This answer is incorrect. According to the policies and procedures provided in *Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting And Auditing Practice* (the AICPA Practice Aid), this procedure supports a different policy—a policy about considering risk associated with professional services in particular circumstances.]

    b. If the nature or scope of the engagement changes, the firm documents the change in an addendum to the engagement letter that is sent to the client. [This answer is incorrect. This is one of the procedures illustrated in the AICPA Practice Aid; however, this procedure supports the policy about obtaining an understanding with the client.]

    c. The firm evaluates whether the firm (or practice office) has, or can reasonably expect to obtain, the knowledge and expertise necessary to perform the engagement, including relevant regulatory or reporting requirements. [This answer is correct. According to the illustrated policies and procedures provided by the AICPA Practice Aid, this procedure supports the policy given above.]

    d. The firm considers the implications for previous engagements with the client, including the need to withdraw previously issued reports. [This answer is incorrect. Based on the policies and procedures outlined in the AICPA Practice Aid, this procedures would provide support for the policy about establishing procedures on withdrawal from an engagement.]

9. Which of the following is a common matter noted in peer reviews related to acceptance and continuance? **(Page 158)**

    a. Too many formal policies or procedures about acceptance and continuance matters. [This answer is incorrect. Issues noted in peer reviews from previous years included the lack of formal policies or inadequate procedures for acceptance and continuance.]

    b. Not evaluating continuance decisions. [This answer is correct. Continuance decisions not being evaluated annually is a common issue related to acceptance and continuance that has been noted in previous years' peer reviews. Another example of such a matter is that acceptance decisions are not adequately documented in accordance with standards.]

    c. Documentation of the firm's communication with predecessor auditors. [This answer is incorrect. The issue peer reviewers are more likely to note about acceptance and continuance, as illustrated in previous years' peer reviews, is failure to communicate and/or document communication with predecessor auditors.]

    d. Obtaining licenses in multiple states. [This answer is incorrect. As illustrated in peer reviews from previous years, a common issue is failure to obtain a license in all states where engagements were accepted.]

Lesson 2: Human Resources

INTRODUCTION

One of the most important aspects of a firm's quality control system is the proficiency of its personnel. A firm's goal is to have personnel with integrity, objectivity, competence, intelligence, and motivation who can plan, perform, supervise, and review work. The quality of a firm's work ultimately depends on how effectively the firm utilizes and manages its personnel to perform their assigned responsibilities. This function is often known as personnel management, but the quality control standards use the term *human resources*.

Learning Objectives:

Completion of this lesson will enable you to:
- Recognize issues related to recruitment and hiring, competencies and capabilities, and assigning staff to engagement teams.
- Determine appropriate responses and strategies for professional development; performance evaluations, compensation, and advancement; drafting appropriate QC policies and procedures; and evaluating the QC system's design.

Authoritative Literature

This lesson provides information to assist firms in understanding and complying with the authoritative literature that addresses human resources as part of the firm's system of quality control pursuant to SQCS No. 8, *A Firm's System of Quality Control* (QC 10). Additionally, the auditing, attestation, and compilation and review professional standards incorporate engagement-level quality control requirements leveraged from QC 10. AU-C 220, *Quality Control for an Engagement Conducted in Accordance with Generally Accepted Auditing Standards,* provides guidance specific to the performance of audit engagements, generally focusing on the responsibilities of the audit partner and engagement team. AT-C 105, *Common Concepts to All Attestation Engagements,* provides quality control-related guidance for the assignment of the attestation engagement team and the practitioner's specialists. AR-C 60, *General Principles for Engagements Performed in Accordance with Statements on Standards for Accounting and Review Services,* provides general guidance related to the accountant's responsibility with regard to the overall management and performance of SSARS engagements.

Thus, all authoritative pronouncements over attest engagements (that is, the SASs, SSAEs, and SSARS) require firms and their engagement partners to adhere to the requirements of QC 10. Additionally, the authoritative literature of the AICPA *Code of Professional Conduct* (the Code), other AU-C sections, SSAE No. 18, and the SSARS all provide guidance that addresses certain aspects of the human resources quality control (QC) element, such as competency. That information is discussed in various sections of this lesson.

Requirements

The requirements of the authoritative literature discussed above that relate to the human resources QC element are detailed in Exhibits 2-1 through and 2-4.

Exhibit 2-1

Requirements for Human Resources QC Policies and Procedures under QC 10

Requirements	QC 10
Human Resources	
The firm should establish policies and procedures to provide reasonable assurance that it has sufficient personnel possessing the competence, the capabilities, and the commitment to ethical principles necessary to (1) perform engagements as required by professional standards and applicable legal and regulatory requirements and (2) enable the firm to issue reports that are appropriate in the circumstances.	QC 10.31
The firm's policies and procedures should provide that personnel chosen for advancement possess the qualifications necessary to fulfill the responsibilities that they will be called upon to assume.	QC 10.32
Assignment of Engagement Teams	
The firm should delegate responsibility for each engagement to a specific engagement partner and should establish policies and procedures that require— • The identity and the role of the engagement partner be communicated to management and those accountable for governance. • The engagement partner possesses the appropriate competence and capabilities, and is given the authority to perform the role. • The responsibilities of the engagement partner are explicitly defined and communicated to him or her.	QC 10.33
The firm should establish policies and procedures to designate appropriate personnel possessing the necessary competence and capabilities to (1) perform engagements as required by professional standards and applicable legal and regulatory requirements and (2) enable the firm to issue reports that are appropriate in the circumstances.	QC 10.34

* * *

Exhibit 2-2

Requirement for Human Resources QC Procedures under AU-C 220

Requirement	AU-C 220
Assignment of Engagement Teams	
The engagement partner should be satisfied that the audit engagement team (including any external specialists) possesses the appropriate competence and capabilities to (1) perform the audit engagement as required by professional standards and applicable legal and regulatory requirements, and (2) enable the issuance of an auditor's report that is appropriate in the circumstances.	AU-C 220.16

* * *

Exhibit 2-3

Attestation Engagement-level QC Requirements under AT-C 105

Requirements[a]	AT-C 105
The engagement partner should be satisfied that the attestation engagement team (including any practitioner's external specialists) has the appropriate competence, including knowledge of the subject matter, and capabilities to (a) perform the attestation engagement in accordance with professional standards and applicable legal and regulatory requirements, and (b) enable the issuance of a practitioner's report that is appropriate in the circumstances.	AT-C 105.32(a)
When the work of a practitioner's external specialist and/or another practitioner are to be used, the engagement partner should be satisfied that the engagement team will be able to be involved in the work to an extent that is sufficient to accept responsibility for the opinion, conclusion, or findings on the subject matter or assertion.	AT-C 105.32(b)
The engagement partner should be satisfied that those involved in the engagement have been informed of their responsibilities, including the objective of the procedures they are to perform and matters that may affect the nature, timing, and extent of such procedures.	AT-C 105.32(c)
The engagement partner should be satisfied that the engagement team members have been directed to bring to the partner's attention significant questions raised during the engagement so that their significance may be assessed.	AT-C 105.32(d)

Note:

[a] SSAE No. 18 is effective for attestation reports dated on or after May 1, 2017, with early application permitted. The requirements in this table should be considered once a firm begins following SSAE No. 18.

* * *

Exhibit 2-4

SSARS Engagement-level QC Requirements under AR-C 60

Requirements	AR-C 60
The engagement partner should possess the appropriate competence and capabilities specific to the SSARS engagement performance and its associated financial reporting.	AR-C 60.20
The engagement partner has to be satisfied that the SSARS engagement team collectively has the appropriate competence and capabilities to (1) perform the SSARS engagement as required by professional standards and applicable legal and regulatory requirements, and (2) enable the issuance of a SSARS report that is appropriate in the circumstances.	AR-C 60.21(d)(ii)

* * *

Definitions

To better understand the authoritative guidance of QC 10with regard to human resources, it is helpful to be familiar with certain terms that are defined in the quality control standard at QC 10.13. These terms are discussed in the following paragraphs.

Personnel. According to QC 10, only partners and staff are considered *personnel*. Thus, the definition of *personnel* encompasses only professional-level individuals. Use of the term *personnel* generally seems to include, but is not limited to—

a. CPAs, including those qualified to seek that status.

b. Part-time professional employees who work year-round on accounting and auditing engagements.

c. Seasonal professional employees who work for the firm on accounting and auditing engagements during peak workload periods.

d. Contract professionals who may work on special nonrecurring projects for the firm or may be contracted to assist on accounting and auditing engagements during peak workload periods.

e. Professional employees that work on specific areas of the engagement, such as an IT or valuation specialist.

Partner. A *partner* is considered to be any individual possessing the authority to bind the firm with respect to the performance of professional services engagements. For purposes of this definition, *partner* also includes any employee who possesses this authority without assuming the additional risks and benefits of ownership. Firms use a variety of titles to refer to such individuals with this authority.

Engagement Partner. The QC standard considers an *engagement partner* to be the partner or other designated individual in the firm who has the responsibility for the engagement and its performance and for the reports issued on behalf of the firm and who, when required, has the appropriate authority from a professional, legal or regulatory body.

Staff. *Staff* is considered to be all firm professionals and specialists, excluding partners.

Suitably Qualified External Person. The term *suitably qualified external person* encompasses any individual outside of the firm possessing the competence and the capabilities to act as an engagement partner (for example, a partner of another firm).

Summary of the Lesson

QC 10 explains that personnel issues relevant to the firm's policies and procedures for the human resources QC element include, for example—

- Recruitment and hiring, if applicable.
- Determining competencies and capabilities, including time to perform assignments.
- The estimation of personnel needs.
- Professional development.
- Performance evaluation, compensation, and advancement.

Each of the above personnel issues is discussed in a separate section of this lesson. The lesson covers the following topics:

- Recruitment and hiring.
- Determining competencies and capabilities.
- Assignment of engagement teams.

- Professional development.
- Performance evaluation, compensation, and advancement.
- Drafting the firm's QC policies and procedures.
- Evaluating the overall adequacy of the QC system's design.
- Monitoring compliance with the firm's human resources policies and procedures.

CONSIDERATIONS FOR RECRUITMENT AND HIRING

QC 10 does not stipulate any specific requirements related to recruitment and hiring, but it does provide application and other explanatory material for establishing policies and procedures for recruitment and hiring. It is a best practice for firms larger than a sole practitioner to establish quality control policies and procedures for recruitment and hiring of employees to help assure that the firm recruits and hires individuals who will meet the general human resource QC requirements discussed later in this lesson.

As a firm addresses the personnel issues covered by the human resources element of the QC standard, it generally determines the number and characteristics of the individuals needed to perform the firm's engagements. QC 10.A17 indicates that effective recruitment processes help the firm select individuals with integrity who—

- Have the ability to develop the competence and capabilities necessary to perform the firm's work.
- Possess characteristics to enable them to perform competently. Such characteristics may include—
  - Meeting minimum academic requirements established by the firm.
  - Exhibiting maturity, integrity, and leadership traits.

Plan for the Firm's Personnel Needs

At least annually, it is a best practice for firm personnel to be assessed by the individual responsible for staffing decisions (generally a partner, managing partner, or other individual assigned responsibility for recruitment and hiring). In determining that individual or group of individuals, the firm needs to remember that such individuals will be representing the firm and promoting its benefits against other prospective employers.

Among the criteria the firm may consider in performing a staffing assessment are the following:

- *Ability to Service Clientele.* The firm needs to evaluate the ability of its staff to provide quality services to its existing clients. Factors to consider include timely completion of engagements, expertise needed in specialized areas, and additional services that may be requested.
- *Anticipated Growth.* If the firm plans to pursue and promote growth of its client base, then the staffing necessary to support such growth needs to be considered and estimated.
- *Personnel Turnover.* In assessing staffing needs, turnover is a consideration. Although the timing of staff attrition is difficult (if not impossible) to predict, firms need to plan for turnover to occur as part of developing personnel needs.
- *Individual Advancement.* The ability of staff members to advance and assume greater responsibility depends, at least to a certain extent, on having qualified personnel to move into the job position left open by the advancement. Accordingly, the firm's advancement plans will often have an impact upon the need to hire a new staff person. Many of the considerations used in developing the firm's recruitment and hiring plan will be applicable in developing an advancement plan.
- *Anticipated Workload.* Firms generally have at least one busy season with heavy workloads during the year that are followed by less busy times (and perhaps even occasional slack times) during other months.

Various alternatives exist to handle changing workload demands, including (a) working planned overtime hours during the busy season, and (b) hiring part-time or contract personnel. The approach and philosophy for handling busy season workloads has a major impact on hiring decisions.

- *Quality of Life.* Many candidates seeking employment today value work/life balance. A firm environment that does not allow some quality-of-life features may find it difficult to hire and retain employees.

- *Succession Plans.* Partner succession plans need to be considered when designing both a hiring and advancement plan. If retirement of a key partner or manager is imminent, a special hiring need for an experienced professional will exist if the firm does not prepare an existing employee to fill that role.

Documenting the Recruitment and Hiring Plan. The degree of documentation used by a firm depends on the size of the firm and the complexity of its annual recruitment and hiring needs. Obviously, a sole practitioner with a small staff of paraprofessionals normally would not need to document a recruitment and hiring plan. However, as a firm grows in size and additional staff is needed, the benefits of documenting such a plan become more apparent. Also, as part of its peer review, the firm will ordinarily be asked whether a recruitment and hiring plan was developed. Accordingly, it is a good idea for firms to annually document their considerations and plans for recruiting and hiring new staff. Even small firms can easily document such information in a memorandum or minutes to partner meetings. Exhibit 2-5 illustrates wording that might be used to document the planning process for recruitment and hiring.

Exhibit 2-5

Memo or Minutes Documenting Recruitment and Hiring Plans

On July 15, 20XX, [Names of Personnel Present at the Meeting] met to (1) evaluate our 20XX/XY recruitment and hiring activities, (2) assess the effectiveness of our recruitment and hiring QC system, and (3) develop our recruitment and hiring plan for 20XX/XY.

Based on an assessment of our personnel needs, prior year recruitment and hiring activity, and a review of the personnel files of employees hired during the current year, we concluded that our recruitment and hiring QC system is adequate and operating effectively. [If problems were noted, alter the conclusion and cite such problems, along with any corrective actions or modifications to the recruitment and hiring QC policy and procedures.]

After considering, among other things, our ability to service current clientele, future growth plans, personnel turnover, future advancement plans, current staff workloads, quality of life considerations, and retirement, we plan to add [Insert number of people and the level of experience desired for each.] to our staff in 20XX/XY or as soon as qualified candidates become available.

We considered various recruiting techniques and determined that we will seek qualified entry-level employees through on-campus interviews at [Names of Colleges and Universities] and we will seek more experienced personnel by [List methods.] .

The recruitment and hiring plan developed during this meeting will be communicated to all personnel involved in the recruitment and hiring process who were not present at the meeting.

* * *

Communicating the Plan to Those Responsible for Recruitment and Hiring. Some firms may include in their QC procedures communicating the recruitment and hiring plan to those individuals responsible for such activities. This is common in large firms that have separate recruiting and hiring functions. However, in a small firm, the partner (or committee) who designs the recruitment and hiring plan may also be responsible for recruiting, interviewing, and hiring. Accordingly, many local firms have no need to address such a consideration in their QC procedures. If such communication is deemed necessary, documentation of the communication can be made in the annual planning memorandum or in the partner meeting minutes. Exhibit 2-5 illustrates alternative wording to document the communication.

Determining Attributes of New Employees

Once the firm assesses its projected personnel requirements, the firm can determine the qualities sought in potential new employees. It is important to the success of hiring a qualified candidate for the firm to know what traits and abilities they desire in an employee before the recruitment process begins. At the same time, it is unlikely that any one candidate will possess every attribute the firm is seeking. The following considerations enter into the determination of employee qualities sought:

- *Educational and Academic Requirements.* An individual's educational background gives insight into three concerns: (a) whether the individual has the intellectual capacity to perform the job and advance within the firm, (b) whether the individual possesses specialized academic training necessary for the job, and (c) whether the individual has the educational degree requirements to pass the CPA exam. Firms often require that potential candidates have a college degree, majored in accounting, and maintained a certain grade point average. While most firms prefer to hire individuals who meet those qualifications, it is not always possible to find such an individual at the time the firm has the need to hire. Accordingly, a recruiting and hiring procedure that addresses the requirements of potential new employees needs to give the firm a sound principle with flexible alternatives.

- *Experience Requirements.* The amount of prior experience the firm desires in potential candidates depends on the level of staff person the firm seeks to hire. Generally, when documenting the firm's annual hiring plan, the firm can be more specific about the experience levels being sought for new employees. For example, a hiring plan might state that the firm plans to hire two entry-level, degreed accountants and one experienced accountant, who ideally has two to three years of public accounting experience. The annual recruitment and hiring plan memorandum illustrated in Exhibit 2-5 can be expanded to specifically address the experience attributes that the firm seeks in new employees.

- *Integrity, Honesty, Maturity, Motivation, Leadership Ability, etc.* Personality attributes are a very important consideration. However, like experience attributes, a specific emphasis on any one attribute over another in a recruitment and hiring procedure statement would make the firm's QC system too restrictive. Accordingly, it is a best practice to make only a general statement about personality attributes the firm seeks in hiring employees.

- *Considering Paraprofessionals.* While most firms desire degreed individuals who majored in accounting, firms should not overlook the many nondegreed candidates who, with proper supervision, can make excellent additions to the staff as paraprofessionals. Paraprofessionals are individuals who possess basic bookkeeping and accounting skills but lack the education or experience to be a member of the professional staff. Paraprofessionals may be hired to assist with routine accounting, bookkeeping, and tax engagements, allowing the firm's professional staff time to concentrate on more difficult assignments. When properly supervised, paraprofessionals can often perform write-up services, tax return preparation, and client billing. Paraprofessionals can also train client bookkeeping staff and prepare depreciation and debt amortization schedules. Since paraprofessionals are generally less costly to hire and retain than professionals, they should not be summarily dismissed as an option. As previously mentioned, a recruiting and hiring procedure that addresses the requirements of potential new employees needs to give the firm a sound principle with flexible alternatives.

Documenting the Attributes Sought. The QC procedure that addresses the attributes sought in a candidate by the firm generally serves as adequate documentation during peer review. However, the peer reviewer may ask to scan the personnel files of new employees to make a determination regarding whether those employees meet, in general terms, the attributes defined by the firm in its QC system. As previously mentioned, it is a good idea to state the attributes listed in the QC system in general terms because it is not always possible to hire employees that possess every attribute. However, if the firm chooses to specify the attributes it desires its candidates to possess, the firm may also want to include a procedure in its QC system that allows the managing partner to override those attributes and hire in unusual situations. Also, when making an assessment about new employees, a peer reviewer may want to look in the personnel file for supporting evidence that the firm properly evaluated the employee before he or she was hired. Such documentation is discussed later in this lesson.

Developing a Recruitment Plan

After the firm identifies the number of employees it needs and their attributes, a recruiting plan can then be developed. Many techniques can be used to recruit personnel, and the methods used vary, depending on the number of employees being sought and the particular experience level needed. Because of the many recruiting alternatives available, the firm may have a larger pool of candidates to choose from by not limiting itself to only one or two techniques in its recruiting plan. In fact, the firm may choose to avoid specifying any particular recruiting techniques. The following paragraphs discuss some commonly used recruiting techniques.

On-campus Recruiting. This technique is often successful for obtaining new, qualified entry-level employees. However, on-campus recruiting can be expensive because it often requires at least one member of the firm to conduct on-campus interviews at each college or university visited. Many practitioners believe that it is difficult for a small firm to compete against large, regional or national firms in on-campus recruiting settings, especially for top candidates. However, this may not always be the case, so the following observations can be helpful to smaller firms:

- Small firms that present themselves as professional, high-quality organizations with advancement and learning opportunities (such as providing a wide variety of work experience that cannot normally be matched by the regional and national firms) compete very effectively for top candidates. The key to competing with the larger firms is to effectively convey the advantages of the smaller firm.

- A high-quality printed brochure and website describing the firm, including its location, partners, staff, clients, working conditions, and benefits, is invaluable in projecting a professional image.

- Consider filing a brief, one-page profile of the firm and description of the positions open and the desired qualifications of applicants with the school's placement office.

- Maintaining a good relationship with the accounting faculty is important to on-campus recruiting. A firm that shows an interest in the college or university and its accounting program is noticed by the faculty members and accounting students. An excellent way to foster this relationship is to use staff or partners who are alumni of the college or university to conduct that college's on-campus interviews and to meet with the faculty during the visit. Also, firms that volunteer to provide speakers for various accounting student groups, such as the accounting club or honorary fraternities, keeps the firm visible and lets students know that the firm is a viable employment option.

Establish a Formal Internship Program. Firms that develop a presence on college and university campuses may want to consider developing a student internship program. Having an internship program gives both the firm and the student the opportunity to "check each other out" before making a more definite commitment. The firm could consider having at least one intern per year for every anticipated open entry-level position in the firm. The work assigned to the intern needs to be meaningful to provide the firm and the student intern the best opportunity to determine whether the fit is a good one. If the relationship is determined to be a good fit, the intern will often choose to stay with the firm post-graduation.

Referrals. Referrals from business contacts, clients, college professors, and other sources can be valuable resources for potential new employees. Such sources are often aware of individuals who are considering making an employment change. Additionally, firms may encourage current employees to refer friends or acquaintances for job openings. Presumably, employees know what the firm expects and will refer candidates with good work habits and other characteristics the firm seeks. Firms can encourage such referrals by providing tools that are easy to use when employees have a referral to make. Use of referral cards or an online form to report a prospect to the right person in the firm who will contact the referred candidate allows existing personnel to quickly provide potential new employee recommendations.

Periodical Advertising. Employment advertisements placed in professional periodicals can be effective for attracting experienced personnel. State and local CPA societies often have a section in their magazines or newsletters for placing such advertisements. To cut down on the number of unqualified applicants responding to periodical advertising, the firm needs to carefully word these advertisements to pinpoint the specific type and level of applicant it seeks.

Use of Websites. Many firms today use their websites as recruiting tools. Because today's college students have grown up in a highly technological society, the firm's use of technology may be an important job selection criterion. College students are comfortable seeking job opportunities online and spend a lot of time on the Internet visiting firm websites. As a result, the firm's web presence can have a significant impact on its recruiting effort. Placing recruiting information on the firm's website may serve a two-fold purpose—to provide recruits with information about the firm and to convey a positive impression about the firm's use of technology.

In addition to recruiting on its website, a firm can list job openings on sophisticated recruiting websites. This can be particularly effective if the firm is looking for specific expertise that may not be available locally. The reach of potential job candidates available through recruiting websites is enormous. Accounting firms have never before been able to deliver their recruiting messages to so many individuals so inexpensively.

Use of Employment Agencies and Search Firms. Some qualified job seekers work with agencies or executive search firms and can be identified by contacting those sources. However, because the associated fee is usually high, this technique is less commonly used unless a highly specialized or difficult-to-find individual is sought.

Recruitment Is a Two-way Process. The potential employee seeks to sell his or her qualifications to the firm, while the firm strives to sell its merits to the potential employee. Too often a firm concentrates on evaluating the candidate and forgets to sell the firm. The most effective recruiting plans contain guidelines to assist the interviewer in presenting the firm in a positive light. In today's competitive hiring environment, it is important that firm recruiters and interviewers know how to emphasize the advantages and benefits of their firm to desirable candidates.

Documenting the Recruitment Plan. Firms can combine documentation for both the recruitment and hiring plans. However, firms may choose to document the recruitment plan separately from the hiring plan. Regardless of whether recruitment plan documentation is combined or separated from the hiring plan, the documentation procedures discussed earlier in this section are appropriate. Exhibit 2-5 illustrates suggested wording for documenting a combined hiring and recruitment plan.

Screening Potential Candidates. The hiring process may produce a large number of applicants, particularly in a slow economic climate. Firms can narrow the field of candidates by screening applicants in a nondiscriminatory fashion to identify individuals who appear to possess the desired qualifications. After the pool of potential candidates has been screened, the firm can then evaluate in more detail the candidates who pass the screening process. Additionally, firms need to avoid documenting a candidate's review on the individual's resume or application as some state laws allow applicants to obtain a copy of their resume or application at the conclusion of the evaluation process.

Evaluating the Candidates

The most critical step in the recruitment and hiring process is evaluating prospective employees. The attributes that many firms seek in candidates were discussed earlier in this section. During the evaluation stage, the individual in the firm responsible for hiring makes a judgment of whether or not the candidate possesses those attributes. In making this judgment, both objective considerations (grade point averages, college courses, prior work experience, aptitude tests, etc.) and subjective considerations (the individual's personal appearance and response to questions, how references respond, and the interviewer's general perceptions) are evaluated.

Many firms attempt to define in their recruitment and hiring system specific criteria that are to be met when evaluating a potential employee. For example, some firms stipulate that a college transcript be obtained for every candidate, that a certain number of references be obtained from each candidate, and that every reference be contacted and those communications documented. While a sound evaluation procedure is necessary, this course suggests that, especially for small to medium-sized firms, the evaluation procedures ought to be stated in terms of general guidelines, not specific requirements. At the same time, the evaluation procedures should not be too vague or unstructured.

To obtain proper structure and yet maintain flexibility, a firm can adopt an evaluation checklist to guide the process. Such a checklist helps ensure that the firm presents itself in a formal, structured manner to a potential employee instead of in a disorganized, haphazard manner. The use of a checklist may be incorporated into the candidate evaluation procedures.

The evaluation process for an individual with prior professional work experience will be somewhat different than the process for a recent college graduate. When seeking an individual with prior professional work experience, the firm may devote much of its efforts to learning and substantiating that work experience. Firms may want to consider performing more than the basic reference checks. Firms may consider verifying employment history, including salaries, and performing criminal background checks, including inquiring about any outstanding regulatory actions. When requesting information from former employers, concentrate on the candidate's work habits, attendance record, dependability, personal qualities, and other job-related matters. The intent is for the information to confirm what has already been provided by the candidate. A full pre-employment check is only necessary on those two or three final candidates the firm desires to know more about.

Additionally, it is important for firms to avoid documenting a candidate's review on the individual's resume or application, as some state laws allow applicants to obtain a copy of their resume or application at the conclusion of the evaluation process.

Explaining Firm Policies and Procedures to Job Candidates and New Employees

The need to communicate firm policies and procedures occurs at two different points in the hiring process: (a) when the firm makes formal contact with a prospective candidate, and (b) when the candidate becomes an employee. The first communication is obviously more general in nature, while the communication made to a new employee is very detailed. For example, during the interview and initial contact stage, prospective candidates can be told in general terms about the firm's overtime, vacation, CPE, advancement, and other human resource policies. Some firms may use a brochure to accomplish the first communication, while other firms rely on the interviewer to orally communicate such policies. Many small firms find that an interview checklist can be used to remind the interviewer to communicate such information. In addition, many firms use an employment application to convey important information to candidates.

A detailed discussion of recruitment and hiring is beyond the scope of this course. *PPC's Guide to Managing an Accounting Practice* provides detailed information of the hiring process, including avoiding discrimination, identifying staffing needs, recruiting, screening and interviewing candidates, performing reference checks and pre-employment testing, employment offers and rejections, documenting the hiring process, and welcoming the new employee. When hiring, firms may want to use an employment application. Because employment regulations vary by state and locality, any employment application used by CPA firms is best approved by an attorney experienced in employment law.

Once the prospective candidate becomes an employee, the communication of firm policies and procedures naturally becomes more formal. Firms can provide an orientation to new hires that, among other things, communicates the firm policies and procedures. Larger firms that maintain personnel manuals often accomplish this communication by distributing the manual to new employees and have them affirm that they have read the manual. While small to medium-sized firms may not maintain personnel manuals, an orientation checklist can be used to communicate and document this requirement.

Firms may also request employees sign an employee confidentiality agreement to help the firm protect its clients' financial and business information and protect the firm from an advertent or inadvertent leak of information by the staff. Because employment regulations vary by state and locality, employment forms used by the firm are best reviewed by an attorney experienced in employment law.

HOW TO DETERMINE COMPETENCIES AND CAPABILITIES

QC 10.31 indicates that the firm should establish policies and procedures over the human resources quality control element designed to provide reasonable assurance that the firm has sufficient personnel with the competence, capabilities, and commitment to ethical principles. Such traits are necessary to help assure engagements are performed in accordance with professional standards and applicable legal and regulatory requirements, and to enable the firm to issue appropriate reports in the circumstances.

Competencies and capabilities are described in QC 10.A18 as the knowledge, skills, and abilities qualifying personnel to perform engagements. For the purpose of the QC standard, *competencies* and *capabilities* are qualitative rather than quantitative because quantitative measurements may not accurately reflect the kinds of experiences gained by personnel in any given time period. This course recommends that the concept of *competencies and capabilities* is addressed at two levels. One level is the individual employee level; that is, whether personnel within the firm have adequate and appropriate competencies and capabilities for their position. The other level is at the engagement team level, where the firm considers whether the engagement team has adequate and appropriate competencies and capabilities for the specific engagement roles assigned, considering the nature of the engagement. This section primarily addresses the consideration of individual employee competencies and capabilities. Considering competencies and capabilities at the engagement level is primarily addressed, along with other engagement assignment considerations, later in this lesson.

In the context of QC 10, an individual is *capable* if he or she has the ability to perform a specific task. An individual is *competent* if he or she has the requisite skill or expertise needed to perform the task. For example, a CPA may be considered *competent* to be the engagement partner for an audit engagement of a financial institution. However, because the engagement partner is already fully scheduled for the next four months, he or she is not *capable* of taking on that engagement. In another example, a CPA may have the technical proficiency needed to perform certain complex tasks. Thus, the CPA is *competent*, yet the CPA has not developed the ability to manage and oversee a project that includes use of those complex tasks. While this CPA can perform the complex tasks, he or she cannot manage the assignment because the individual is not yet *capable* of holding the leadership role.

Developing a Professional's Competence

QC 10.A19 conveys that an individual's competence is developed through a variety of methods, such as—

- Professional education.
- Continuing professional development, including training.
- Work experience.
- Mentoring relationships with more experienced staff members.
- Independence education for those individuals who are required to be independent.

Those methods are discussed in the paragraphs below.

Professional Education. A professional's educational background plays a big part in determining competence and capabilities, especially in the early years of his or her career. As a result, firms invest a great deal of time and effort in recruiting graduates with high grade point averages (GPAs) from selected universities. Although no guarantee, a graduate's GPA is often indicative of both the individual's technical knowledge and his or her maturity and focus. A professional's education is the foundation upon which a career of life-long learning and professional development is based.

Passing the CPA Exam. Once an individual obtains their accounting degree, passing the Uniform CPA Examination is often considered to be the next step in their professional education. Firms may discuss the expectation of all new employees passing the CPA exam with candidates during the recruiting process. When firms hire entry-level accounting graduates who have not yet passed the CPA exam, firm management needs to emphasize to those individuals the importance of doing so as soon as possible. Many firms emphasize passing the CPA exam by providing training geared toward passing the exam or reimbursing the employee for taking a CPA review course, as well as regularly checking on each nonlicensed employee's progress toward meeting that goal. Passing the Uniform CPA Examination helps to build competence and capability characteristics in new accountants.

Continuing Professional Development. All CPAs obtain continuing professional education (CPE) based upon membership requirements of the AICPA, state boards of accountancy, and state CPA societies. Certain regulatory agencies also have specific requirements for continuing professional education of individuals who participate in certain engagements of entities subject to their authority. For example, the GAO requires that firms and individuals, who perform audits or attest engagements under *Government Auditing Standards*, meet certain continuing professional education requirements. Firms can help their professional staff gain appropriate competencies by developing a CPE plan for each staff member. Professional education is discussed in more detail later in this lesson.

Continuing professional development has a significant impact on the ongoing competence of the firm's personnel because it facilitates developing and maintaining their technical knowledge and capabilities. Continuing professional development includes activities such as CPE and on-the-job training. Many firms are actively involved in assisting professional staff with those activities. Additionally, some firms may support other professional development activities, such as encouraging staff members to join professional organizations, serve on professional committees, write for professional publications, and speak to professional groups. Professional development is discussed in more detail later in this lesson.

Work Experience. An individual's past work experience has a significant impact upon their capabilities and competence. As individuals gain work experience through a variety of jobs that expose the individual to different areas of practice and different types of engagements, their competence and capabilities increase. Additionally, work experience exposes staff members to different supervisors with differing approaches to performing engagements, and staff members' competence and capabilities are often positively impacted as a result. As individuals demonstrate their increasing competence and capabilities, they are ordinarily promoted to higher positions of responsibility and authority.

Mentoring Relationships. New staff members with no previous professional work experience may be overwhelmed when they begin their first public accounting position. Establishing mentoring relationships between new and experienced staff members can assist in the development of an individual's competencies and capabilities. Another use for mentoring programs is to groom top performing managers into partner positions. Matching a top-quality manager with a respected partner aids the manager in learning the competencies and capabilities of being a partner.

Independence Education. Maintaining independence is a significant and ongoing issue for accountants who provide certain attest services. If an accountant is not independent of a specific attest client, professional standards indicate that the accountant may not provide attest services to that client; the accountant's capability to perform the engagement is jeopardized. It is important for firm personnel to receive independence education to ensure their understanding of the independence requirements to which they are subject. Firms often address independence education as part of overall ethics education, and many state boards of public accountancy require ethics courses to be taken periodically in order for CPAs to maintain their licenses.

Special Considerations—*Government Auditing Standards*

The general standard relating to competence in the *Government Auditing Standards* (Yellow Book) requires that the staff assigned to perform the audit engagement must collectively possess adequate professional competence for the tasks required. Firms should determine that the team assigned to a Yellow Book engagement collectively has the technical knowledge, skills, and experience necessary to be competent for the engagement before beginning work on the engagement. The Yellow Book continuing education requirements are included as part of the competence general standard. The Yellow Book competency requirements are discussed in detail in *PPC's Guide to Audits of Local Governments*, *PPC's Guide to Nonprofit Organizations*, and *PPC's Guide to Single Audits*. A summary of the CPE requirements that must be met by those who work on engagements subject to *Government Auditing Standards* is provided later in this lesson.

Assessing Competency

It is the firm's responsibility to establish criteria by which to evaluate the capabilities and competencies possessed by each employee. The AICPA has created a competency framework detailing the knowledge and skills needed to perform high-quality audit, attestation, review, compilation, and preparation engagements, which may provide a good starting point for such an evaluation. The *AICPA Competency Framework: Assurance Services* includes five core technical competencies skill sets: client acceptance, engagement planning, engagement analysis or testing, concluding the engagement, and guiding principles. Within each of these core skill sets are various functions to assess the level of technical competency as foundational, intermediate, advanced, or expert. Firms can use the framework as a standalone self-assessment tool, and defining the levels of technical competency within the framework allows staff to easily understand the steps needed to reach the next level of technical competency. The framework can be accessed at **competency.aicpa.org/pages/assurance-framework.** The AICPA also provides learning resources to support the competency framework, which are available at **competency.aicpa.org/competencies/232-assurance.** (Other competency frameworks and learning resources are also available, such as governmental auditing, not-for-profit, and more, at **competency.aicpa.org**.)

Using the AICPA assurance competency framework and related learning resources discussed above is one of the many ways a professional's capabilities and competence may be evaluated. It is important that personal characteristics such as integrity, professionalism, motivation, speaking ability, etc., are also evaluated. Generally, the evaluation of individuals is performed on a periodic basis, at least annually.

Competencies of the Engagement Partner

Generally, an engagement partner gains the necessary competencies through relevant and appropriate experience in engagements performed in an accounting and auditing practice. In some cases, however, an engagement partner obtains the necessary competencies through disciplines other than public practice, such as in relevant industry, governmental, and academic positions. If the experience of the engagement partner has not fully developed the necessary competencies, the experience may be supplemented through continuing professional education and consultation.

Engagement partner competencies can be gained in a variety of ways. The following are examples given in QC 10.A25—

- An engagement partner's recent experience consists primarily in providing tax services. In order to acquire the competencies necessary to perform a SSARS engagement, the partner may obtain relevant CPE.

- An engagement partner whose actual experience consists of performing SSARS engagements on historical financial statements may be able to obtain the necessary competencies to perform an audit. The partner may become familiar with the industry in which the client operates, obtain CPE relating to auditing, use consulting resources during the audit engagement, or any combination of those.

- A person in academia can obtain the necessary competencies to perform accounting and auditing engagements by (a) obtaining specialized knowledge through teaching or writing research projects or papers and (b) performing a rigorous self-study program or engaging a consultant to assist on such engagements.

QC 10.33 requires that engagement partners possess appropriate competence and capabilities. Additionally, for engagements performed under the SSARS, AR-C 60.20 requires partners to possess competencies specific to those engagements. Thus, the firm's QC policies and procedures should be adequate to provide reasonable assurance that the engagement partner possesses the competencies necessary to perform the engagement as required by professional standards, regardless of how a particular competency is gained. For example, firms may require that engagement partners who are responsible for highly specialized engagements, take eight hours of industry-specific CPE every two years, or more frequently if new professional standards or regulations affect the particular industry. As another example, firms may require that when an engagement in a new industry is accepted, the engagement partner and other senior members of the engagement take industry-specific CPE before any planning procedures are performed. The competence and capabilities of the engagement team collectively is discussed later in this lesson.

The nature and extent of the competencies a firm expects of an engagement partner is a function of the characteristics of a particular client, industry, and service provided. The following examples illustrate this concept:

- The firm will expect different competencies, depending upon whether an engagement partner is involved with a SSARS engagement or an audit of the client's financial statements.

- Supervising engagements and signing reports for clients in certain industries, such as financial services, governmental, or employee benefit plan engagements, requires different competencies than those expected in performing attest services for clients in other industries.

- The engagement partner for an attestation engagement to examine management's assertion about the effectiveness of an entity's internal control over financial reporting is expected to have technical proficiency in understanding and evaluating the effectiveness of controls, while the engagement partner for an attestation engagement to examine prospective financial statements is expected to have different competencies, including professional judgment to evaluate the reasonableness of the key factors and assumptions used by management in developing the forecast.

The nature and extent of competency requirements necessary for an engagement partner are broad and varied in practice. QC 10.A27 indicates that the following competencies, as well as other competencies, are necessary in the circumstances—

- Understanding the role of the QC system and the Code, both of which are critical to assuring the integrity of accountants' reports.

- Understanding the service to be performed, that is, the performance, supervision, and reporting aspects of the service to be performed. Such an understanding is usually gained through training or participation in the type of engagement under appropriate supervision.

- Technical proficiency in the applicable authoritative standards, including those specific to the client's industry and transactions.

- Familiarity with the industry in which the client operates, including (in an audit or review of financial statements) the industry's organization and operating characteristics, sufficient to identify high or unusual risk areas associated with an engagement and to evaluate the reasonableness of industry-specific estimates.

- Professional judgment, including the ability to exercise professional skepticism and identify areas requiring special consideration, such as evaluation of the reasonableness of estimates and representations made by management and the determination of the kind of report necessary in the circumstances.

- A sufficient understanding of the entity's information technology systems (that is, how the client's entity is dependent on, or enabled by, its IT systems, and the manner in which those systems are used to record and maintain financial information) to determine whether involvement by an IT specialist is necessary for an audit.

The preceding list is not intended to be all-inclusive. Thus, a firm's policies and procedures should also address other competencies as necessary. For example, traits such as the following also represent characteristics that engagement partners should ordinarily possess—

- *Positive personal attributes*, including integrity and ethics, professionalism, and project management skills.

- *Leadership qualities*, including strategic thinking and planning, negotiating and persuading, teamwork, problem solving, coaching, and empowerment.

- *Perspective on business issues*, including managing and developing people, marketing and selling, knowledge of best practices, and business advisory skills.

Nonconforming Engagements Due to Competency Deficiency

The importance of engagement partner and engagement team competency can not be overemphasized. For example, a lack of competency can result in performing audit engagements that do not comply with professional standards and applicable legal and regulatory requirements, and releasing auditor's reports that do not support the expressed opinion. In a situation where engagement performance is deficient and an engagement is found to be materially nonconforming after report issuance (such as through monitoring procedures, peer review, or a regulatory inspection), the firm needs to take immediate action.

Interrelationship of Competencies and Other Quality Control Elements

Competencies, such as those listed above, are interrelated, and gaining one may relate to achieving another. For example, understanding a client's industry relates to the ability to make professional judgments about the client. Likewise, technical proficiency in applicable accounting standards that are unique to the client's industry affects the engagement partner's professional judgment when evaluating the reasonableness of estimates made by client management.

Additionally, policies and procedures relating to the nature of competencies needed by the engagement partner for an engagement may consider the requirements of policies and procedures established for other quality control elements. For example, in determining the degree of technical proficiency necessary for given circumstances, the firm might consider its requirements related to the engagement performance quality control element.

Some of the information covered in recruitment and hiring and assignment of engagement teams can also apply to this section's discussion of determining competencies and capabilities. Much of the discussion of the components of the human resources element of quality control seems to be interrelated.

Relationship of the Human Resource Quality Control Element with the UAA

CPAs are required to follow the accountancy laws of the individual licensing jurisdictions in the United States that govern public practice. Those jurisdictions may have adopted, in whole or in part, the Uniform Accountancy Act (UAA). The UAA is the model legislative statute and related administrative rules designed by the AICPA and the National Association of State Boards of Accountancy, to provide a uniform approach to the regulation of the accounting profession. The UAA mandates that a licensee responsible for supervising attest or compilation services and signing or authorizing someone to sign the accountant's report on the financial statements on the firm's behalf should meet the competency requirements of the professional standards for such services. A firm's compliance with QC 10 is intended to enable a practitioner who performs the services described in the preceding sentence on the firm's behalf to meet the competency requirement referred to in the UAA.

ASSIGNING PERSONNEL TO ENGAGEMENT TEAMS

QC 10 Requirements

QC 10.33 indicates that the firm should assign responsibility for each engagement to an engagement partner and should establish policies and procedures requiring that—

a. The engagement partner's identity and role be communicated to client management and those charged with governance.

b. The engagement partner possesses the appropriate competence, capabilities, and authority to perform the role.

c. The firm clearly defines and communicates to the engagement partner his or her responsibilities.

Further discussion relating to assigning engagement partners to engagements is provided later in this lesson.

While the engagement partner serves an important and vital role in an engagement, the firm should also address staff member engagement roles. Thus, as indicated in QC 10.34, firms should establish policies and procedures to assign appropriate staff with the necessary competence and capabilities to—

a. Perform engagements that comply with professional standards and applicable legal and regulatory requirements.

b. Enable the firm to issue reports that are appropriate in the circumstances.

Further discussion relating to assigning staff to engagements is provided later in this lesson.

Special Considerations—Audit Engagements

AU-C 220 Requirements. AU-C 220 includes requirements relating to the assignment of audit engagement teams. AU-C 220.16 indicates that the engagement partner should be satisfied that the audit engagement team (including participating auditor's external specialists) has the appropriate competence and capabilities to (a) perform the audit engagement as required by professional standards and applicable legal and regulatory requirements, and (b) issue an auditor's report that is appropriate in the circumstances.

AU-C 220.A9 explains that an external specialist may be considered a member of the engagement team if that person performs audit procedures on the engagement, even when such an individual is not an employee of the firm. However, an external specialist is not considered to be a member of the engagement team if that individual's participation in the engagement is limited to consultation. AU-C 220.A10 also provides a list of matters that the engagement partner may take into consideration when evaluating whether the engagement team has the appropriate competence and capabilities. That listing is virtually identical to the information about assigning engagement teams included in QC 10 and provided later in this lesson.

Other Audit Requirements. Requirements of all professional standards should be considered when designing and monitoring a QC system. The auditing standards include other requirements relating to assigning personnel to audit engagement teams—

- AU-C 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Generally Accepted Auditing Standards* (AU-C 200.A47), indicates that proper assignment of personnel to the engagement team enhances the effectiveness of audit procedures.

- AU-C 240, *Consideration of Fraud in a Financial Statement Audit* (AU-C 240.29), states that the auditor should take into account individual team members' knowledge, skills, and abilities when assigning and supervising staff as part of determining an overall response to an assessed risk of material misstatement due to fraud.

- AU-C 300, *Planning an Audit* (AU-C 300.02), states that establishing an overall audit strategy assists in selecting engagement team members with the appropriate capabilities and competence to respond to anticipated risks. AU-C 300.A16 also indicates that the nature, timing, extent of the direction, and supervision of engagement team members will vary based on the assessed risks of material misstatement for assigned audit areas and the capabilities and competence of the team members performing the work.

- AU-C 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained* (AU-C 330.A1), indicates that overall responses to address assessed risks of material misstatement at the financial statement level may include assigning more-experienced staff.

Special Considerations—Attestation Engagements

AT-C 105 is the umbrella section that governs the three types of attestation engagements under SSAE No. 18: examinations, reviews, and agreed-upon procedures engagements. AT-C 105.32–.42 address quality control aspects of attestation engagements, including requirements relating to the assignment of attestation engagement teams. AT-C 105.32(a) indicates that the engagement partner should be satisfied that the attestation engagement team (including any practitioner's external specialists) has the appropriate competence, including knowledge of the subject matter, and capabilities to (a) perform the attestation engagement in accordance with professional standards and applicable legal and regulatory requirements, and (b) issue a practitioner's report that is appropriate in the circumstances.

The related application guidance at AT-C 105.A59–.A60 explains that knowledge about the specific subject matter to which the engagement procedures are to be applied may be obtained through formal education, practical experience, or consultation with others. The guidance includes a list of matters that the engagement partner may take into consideration when evaluating whether the engagement team has the appropriate competence and capabilities. That list of matters is very similar to the information about assigning engagement teams included in QC 10 and discussed later in this lesson, except that the attestation guidance also addresses technical expertise in specialized areas applicable to the subject matter.

AT-C 105.32(b)–(d) include additional requirements for the assignment of the engagement team and the practitioner's specialists. [AT-C 105 defines a *practitioner's specialist* as an individual or organization possessing expertise in a field other than accounting or attestation, and whose work in the field is used to assist in obtaining evidence for the service being provided. Such a specialist may be internal to the firm or the firm's network (known as a *practitioner's internal specialist*), or external to the firm (known as a *practitioner's external specialist*).] Those requirements state that the attestation engagement partner should be satisfied that—

- To an extent that is sufficient to accept responsibility for the opinion, conclusion, or findings on the subject matter or assertion, the engagement team will be able to be involved in the work of a practitioner's external specialist and/or an other practitioner, when the work of such individuals is to be used.

- Those involved in the engagement have been informed of their responsibilities, including the objective of the procedures they are to perform and matters that may affect the nature, timing, and extent of such procedures.

- The engagement team members have been directed to bring to the engagement partner's attention significant questions raised during the engagement so that their significance may be assessed.

Special Considerations—SSARS Engagements

AR-C 60.21 includes the responsibilities of the SSARS engagement partner relating to engagement-level quality control. AR-C 60.21(d)(ii) requires the SSARS engagement partner to be satisfied that the engagement team possesses the appropriate competence and capabilities to (a) perform the SSARS engagement as required by professional standards and applicable legal and regulatory requirements and (b) issue a SSARS report that is appropriate in the circumstances. Additionally, AR-C 60.A43 provides a list of matters that the SSARS engagement partner may consider when determining if the engagement team as a whole has the expected competence and capabilities. That list is virtually identical to the information about assigning engagement teams included in QC 10 and provided later in this lesson.

Special Considerations—Other

***Government Auditing Standards*.** Paragraph 3.01 of the Yellow Book emphasizes the importance of the staff's competence in the performance of financial audits, attestation engagements, and performance audits. Additionally, Paragraph 3.72 of the Yellow Book requires staff assigned to conduct an audit in accordance with those standards to collectively possess the technical knowledge, skills, and experience necessary to be competent for the type of work being performed *before* beginning work on the engagement. (In April 2017, the GAO issued an exposure draft containing proposed updates to the Yellow Book. The exposure draft is available on the GAO's website at **www.gao.gov/products/GAO-17-313SP**. The exposure draft indicates that the effective date for the revision will be included at the time the Yellow Book is issued as final. A future edition of this course will provide more information once the effective date is made known.)

Ethical Requirements. A resolution of the AICPA Council (ET 1.800.001—Appendix B) allows non-CPA ownership in CPA firms, subject to certain conditions. One of the conditions states that CPA-owners must be ultimately responsible for services covered by the SASs, SSAEs, SSARS, and PCAOB standards. That is, non-CPA owners cannot assume ultimate responsibility for any services covered by the standards listed in the preceding sentence.

The Code also provides ethical requirements regarding the performance of professional services. ET 1.300.001, *General Standards Rule*, requires that professional services should be conducted only by those who can complete such services with professional competence and exercise due professional care. The performance of professional services should also be adequately planned and supervised.

Evaluating Client Staffing Requirements and Formulating a Staffing Plan

Before a firm can formulate its staffing plan, it first needs to evaluate the necessary staffing requirements. While this is an intuitive and simplistic step, it is emphasized in this course not because firms have difficulty in evaluating their staffing needs, but because some firms make staff assignments somewhat automatically without conscious assessment of the unique needs of each client engagement, including competency and capability requirements, discussed earlier in this section. Evaluating each engagement's staffing requirements is not a time-consuming or elaborate procedure. It merely includes considering various engagement factors such as the engagement type, size, and complexity; the timing and length of the engagement; etc. A list of engagement factors to consider when formulating a staffing plan is provided later in this lesson.

Considerations in Assigning Engagement Partners. As previously discussed, QC 10 requires firms to assign responsibility for each engagement to an engagement partner and to establish certain policies and procedures relating to the engagement partner's role. QC 10 requires that the engagement partner's identity and role be communicated to client management and those charged with governance. It may be possible to meet this requirement by communicating the required information in the firm's engagement letter. Such a statement added to the engagement letter might read, "[Name of Engagement Partner] is the engagement partner and is responsible for supervising the engagement and signing the report or authorizing another individual to sign it."

QC 10.33 requires the engagement partner to possess appropriate competence, capabilities, and authority to perform the role. Competence of the engagement partner was discussed earlier in this lesson. QC 10 does not address the term *capabilities* separately from competence, although there is some discussion in QC 10 of *competence* alone. Examples of the distinction between *competence* and *capabilities* were provided previously. One of those examples explains that having *capability* includes having the time to perform the work.

To comply with the firm's tone at the top quality initiative, it is important that engagement partners not be overburdened. Accordingly, firms need to monitor the workloads of engagement partners. While it is not expected that engagement partners will never be challenged in managing their responsibilities, when the situation continues for extended periods of time, diminished engagement quality is likely to result. One way firms can monitor engagement partner workloads is to, at least annually, have the committee of partners review and evaluate partner assignments and workloads to ensure that the partners are not overburdened. Such monitoring could be performed in conjunction with the annual partner review of client continuance. Additionally, QC 10.A30 explains that the firm's policies and procedures may incorporate the use of practice management software or other systems to monitor the workload and availability of engagement partners to ensure that engagement partners have adequate time available in their work schedule to appropriately discharge their responsibilities.

Engagement partners should have appropriate authority to perform their role. While it seems intuitive that engagement partners have authority, firms should ensure that engagement partners have the level of authority needed so that engagement quality and ethical commitment is placed above other considerations. For example, if a decision is faced regarding whether to continue an engagement of an ethically questionable client, does the engagement partner have the authority to disassociate from the engagement without having that decision overturned by the managing partner who may be placing profitability before quality? Proper tone at the top is integral to the firm maintaining a culture of quality.

QC 10.33 indicates that the firm should clearly define the responsibilities of its partners and communicate that information to them. Obviously, an individual can only appropriately perform their job responsibilities when they know what those responsibilities entail. The documentation and communication of personnel responsibilities and performance expectations are discussed further later in this lesson.

Considerations in Assigning Engagement Teams. QC 10.A31 suggests that, as personnel are assigned to engagement teams and the level of supervision required is determined, the firm include, for example, consideration of the engagement team's—

- Practical experience with engagements of a similar nature and complexity through appropriate training and participation. Practical experience with such engagements will generally enhance the engagement team's understanding.
- Understanding of professional standards and legal and regulatory requirements.
- Technical knowledge and expertise, including knowledge of relevant information technology.
- Knowledge of industries in which the clients operate.
- Ability to apply professional judgment.
- Understanding of the firm's quality control policies and procedures.

Generally, as the ability and experience levels of assigned staff increase, the need for direct supervision of those staff decreases. In addition, as previously mentioned, AU-C 220 includes the above as matters that the engagement partner may take into consideration when considering whether the audit engagement team has the appropriate competence and capabilities. The SSAEs and the SSARS also include similar guidance, as previously discussed.

Entry-level team members gain their experience and understanding from the ground up in many cases. Appropriate teamwork and training will assist less experienced members of the engagement team to clearly understand the objectives of the assigned work. Accordingly, those less experienced staff members begin to gain more competence through such appropriate teamwork and training.

Formal Time Budgets. It seems likely that, for many local firm engagements (including typical audits of nonpublic companies), the engagement partner can obtain a reliable estimate of staffing requirements without a formal time budget. Yet, there are good reasons for preparing formal time estimates in various circumstances. Such circumstances include—

- First-time engagements.
- Large, complex, and lengthy engagements.
- Audit and review engagements, to analyze the time spent in each area.
- Controlling engagement costs and fees. For example, even a small compilation is more likely to be completed within the expected time frame if each staff person is aware of the engagement partner's time expectation for their specific responsibilities.

While there are many good reasons for preparing formal time estimates, the use of such a tool is an optional procedure in a QC system.

Modify Staffing Assignments Based on Consideration of Competencies. Just as consideration of the competencies appropriate for a particular client is an ongoing process, so is consideration of the competencies possessed by the partner and other personnel assigned to a particular engagement. Matters to be considered may include the following:

- Previously demonstrated competencies in accounting, auditing, and attestation engagements (by considering the results of monitoring and peer review).
- Familiarity with the industry.
- Recent CPE relevant to the level of service to be provided and the industry.
- Performance evaluations.

The firm may decide that modification of the staffing plan is necessary after considering the competence and capabilities of personnel assigned to particular engagements.

Engaging a Qualified Third Party. When a firm does not possess in-house the requisite competencies needed for a particular type of engagement or industry, the appropriate course of action may be to decline the engagement. Some firms might accept the engagement, take a few hours of instructional CPE, and struggle to effectively perform the engagement. However, another option exists. The firm could engage, in a consulting or contracting capacity, a qualified third party with the appropriate knowledge and experience to assist on the engagement. Such an arrangement may be appropriate, for example, when—

- The engagement partner and staff do not each have at least two years of experience in the industry.
- The engagement partner and staff do not each have five years of experience performing audits.
- The firm's personnel have not audited an entity in the particular industry in the preceding five years. (For entities in regulated industries or industries that have undergone significant recent changes, the suggested five-year time period ought to be shortened.)

One likely place to find a qualified third party is to consider the expertise of other accounting firms outside of your market area. An ideal collaborative relationship could develop if your firm also had expertise that the other firm lacked, so that the possibility of providing qualified third-party expertise could work for both firms. Alternatively, joining a firm network could provide access to qualified third-party expertise.

Formulate a Staffing Plan. After the staffing needs of each client and engagement have been identified, the firm is ready to formulate the staffing plan. When formulating a staffing plan, the managing partner or other designated partner is generally responsible for partner and manager assignments. Additionally, the managing partner or other designated partner may assume the responsibility of assigning staff to each client, or the responsibility can be delegated to department heads or engagement partners. When the development of the staffing plan is delegated, the separate plans can be merged into an overall staffing plan and approved by the managing partner or other designated partner.

In making staff assignments, consideration may be given to the following factors:

- The engagement type, size, significance, complexity, and risk profile.
- Special expertise and experience necessary for the engagement.
- New or emerging professional standards and applicable legal and regulatory requirements that may affect the engagement.
- Recent continuing education relevant to the service to be provided and, if applicable, the industry (for example, staff who have met the continuing education requirements of the *Government Auditing Standards*).
- The timing and length of the engagement.
- The continuity and periodic rotation of the staff.
- Opportunities for on-the-job training.
- Satisfying individuals' desires to work on certain engagements or industries.
- Previously demonstrated competencies and capabilities, including consideration of the results of monitoring, inspections, peer reviews, and recent performance evaluations.
- Staff availability and the involvement of supervisory personnel.
- Situations where possible conflicts of interest, objectivity, or independence problems may exist, including, where applicable, circumstances where the assigned staff is not independent under *Government Auditing Standards*.
- The extent of supervision each staff member needs.
- Non-CPA owners cannot be ultimately responsible for any SSARS, attestation, or audit engagement.

Generally, the assessment of client staffing needs and the assignment of staff members occur somewhat simultaneously. An important point to emphasize is that staff assignments are most appropriate when the factors discussed in the previous paragraph and earlier in this section are considered.

Documenting the Staffing Plan. Documentation of the staffing plan need not be elaborate. Firms may simply generate an engagement list from the firm's time and billing system and write the initials of the partner and staff members to be assigned next to each engagement. Alternatively, a firm may use a spreadsheet with dates across the top and staff members' names down the side. Many firms maintain their staffing plan using a spreadsheet application that enables the preparation of numerous arrangements sorted by partner and staff member. However the firm chooses to document its staffing plans, it is important to update the plan for changed staff assignments. A staffing plan that is updated for current year staff assignment changes will be a useful document for preparing next year's staffing plan.

Approving the Staffing Plan. In approving the plan, the managing partner or other designated partner can act as a mediator to help ensure that the factors previously discussed are considered by all partners who assisted in the planning process. It may be more effective for larger firms to assign approval of the staffing plan to the quality control director or a department head. Additionally, firms might require approval of partner and manager assignments from the managing partner or other designated partner in the circumstance of high-risk or significant client engagements. The planning and approval process may be documented in a memo or in minutes of partner meetings. Exhibit 2-6 illustrates such documentation.

Exhibit 2-6

Memo or Minutes Documenting Assignment of Engagement Teams

On July 15, 20XX, [Names of Persons Present] met to evaluate our 20XX/XY assignment of engagement team QC system.

We also reviewed the previously identified competencies that partners in charge of attest engagements should possess, as identified in the Assignment of Engagement Teams section of our quality control document, and concluded those competencies are still appropriate. [If the review concludes that changes are necessary, the changes and the reasons for the changes should be described.]

Prior to the meeting, the firm's client and engagement list was circulated to all partners and they were asked to develop a staffing plan for each of their engagements, considering the factors documented in our assignment of engagement teams QC policy and procedures. These plans were reviewed by the managing partner and [his OR her] recommendations or questions about the plans were discussed during the meeting. After a consensus was reached regarding the staffing of each engagement, the staffing plan was approved, and the managing partner appointed [Name of Appointed Person] to consolidate the plan into one document. Recruitment and hiring, determining competencies and capabilities, professional development, and performance evaluation, compensation, and advancement considerations evolving from this meeting are as follows. [List such considerations for future discussion during those planning meetings.]

* * *

Modifying the Staffing Plan for Unforeseen Events

Regardless of how conscientiously a staffing plan is developed, unforeseen events may occur that will result in it needing modification. If the firm has created its staffing plan using a spreadsheet application, practice management software, or other similar electronic tool, changes are relatively easy to manage. Changes in personnel assignments are most appropriately made after reconsidering the factors previously discussed. The quality control director or managing partner needs to mediate any disputes among engagement partners or staff when there are disagreements regarding changes to staff assignments.

Communicating Staff Assignments

Communication of the assignments to staff can be accomplished in several ways. In a small firm, the complete master staffing plan can be emailed to each staff member, posted in a central location such as the library or break room, or photocopied and distributed to each staff member. (Some firms prefer to communicate the staffing plan in shorter increments of time, such as monthly, bimonthly, or quarterly.) If the staffing plan is maintained using a spreadsheet application, the plan can be sorted by staff member name, allowing each staff member to have a separate assignment schedule. Sole practitioners, or small firms with few staff members, may choose to communicate staffing assignments orally.

SELF-STUDY QUIZ

Determine the best answer for each question below. Then check your answers against the correct answers in the following section.

10. Which of the following firms most likely will need recruitment and hiring in the foreseeable future?

    a. Blue Firm plans to stick with its current client base for at least the next year.

    b. Red Firm does not anticipate any staff turnover in the near future.

    c. Yellow Firm can adequately meet all its current clients' needs.

    d. Green Firm has a staff member who is ready to become a partner.

11. What is a benefit of hiring a paraprofessional?

    a. They require little to no supervision.

    b. They are less costly to hire.

    c. They have all the latest education.

    d. They tend to focus on more difficult projects.

12. The most effective recruiting plans will help a firm do which of the following?

    a. Document the hiring plan separately from the recruitment plan.

    b. Evaluate all potential candidates in detail.

    c. Present itself to the potential employee in a good light.

    d. Focus on one or two recruitment methods.

13. Which of the following statements most accurately describes an aspect of evaluating prospective employees?

    a. The evaluation should focus on objective considerations, such as prior work experience.

    b. Evaluation procedures should be kept as vague as possible to allow latitude when hiring.

    c. Using a checklist can help the firm present itself professionally.

    d. The evaluation process should be the same for all potential candidates to avoid discrimination.

14. Which of the following is a type of continuing professional development?

    a. On-the-job training.

    b. The CPA exam.

    c. Work experience.

    d. The AICPA competency framework.

15. Which of the following requirements must be met when assigning engagement partners to particular engagements?

    a. The engagement partner should define his responsibilities for the firm and the supporting engagement staff.

    b. The engagement partner's identity and role should be communicated to the client's management.

    c. The engagement partner must have competence and capabilities to ensure that the firm issues appropriate reports.

    d. The engagement partner must have competence and capabilities to perform engagements that apply with professional standards.

16. When might an engagement partner want to prepare a formal time budget when assigning staff to an engagement?

    a. The engagement is for an existing client.

    b. The engagement will be short and simple.

    c. The engagement is either an audit or a review.

    d. When it is required by the firm's QC system.

17. Which of the following statements best describes an issue related to staffing the firm's engagements?

    a. Once a staffing plan is made, it should stay the same for continuity reasons.

    b. The best place to find an experienced third party is in the firm's same geographic area.

    c. Effective QC plans will require that the staffing plan is communicated in a written format.

    d. Items such as engagement type and size and necessary experience may affect staffing assignments.

SELF-STUDY ANSWERS

This section provides the correct answers to the self-study quiz. If you answered a question incorrectly, reread the appropriate material. **(References are in parentheses.)**

10. Which of the following firms most likely will need recruitment and hiring in the foreseeable future? **(Page 167)**

    a. Blue Firm plans to stick with its current client base for at least the next year. [This answer is incorrect. If the annual staffing assessment shows that the firm plans to pursue and promote the growth of its client base, then the staffing necessary to support such growth needs to be considered and estimated. Since Blue Firm is not planning to grow in this way during the current year, it does not need hiring and recruiting in this area. However, the annual staffing assessment might reveal other areas in which hiring and recruitment would be necessary.]

    b. Red Firm does not anticipate any staff turnover in the near future. [This answer is incorrect. Personnel turnover is an important part of the annual staffing assessment. However, as Red Firm does not think this is probable in its current situation, recruitment and hiring is not necessary at the moment. However, the Red Firm should keep in mind that turnover cannot always be anticipated and have plans in reserve.]

    c. Yellow Firm can adequately meet all its current clients' needs. [This answer is incorrect. If the firm were unable to meet its clients' needs, it would need to consider hiring more personnel. As that is not the case for the Yellow Firm, its annual staffing assessment would need to find a concern in another area for it to need hiring and recruiting.]

    d. Green Firm has a staff member who is ready to become a partner. [This answer is correct. One area the annual staffing assessment should cover is individual advancement. The ability of staff members to advance and assume greater responsibility, as outlined in this scenario, depends, at least on a certain extent, on having qualified personnel to move into the job position left open by the advancement. Accordingly, the firm's advancement plans will often have an impact upon the need to hire a new staff position, which the Green Firm will now need to do.]

11. What is a benefit of hiring a paraprofessional? **(Page 169)**

    a. They require little to no supervision. [This answer is incorrect. Because paraprofessionals are not considered professional staff, they will need supervision to perform their duties.]

    b. They are less costly to hire. [This answer is correct. Generally, paraprofessionals are less costly to hire and retain than professionals. Therefore, firms should not discount them in their recruitment and hiring process.]

    c. They have all the latest education. [This answer is incorrect. Paraprofessionals are individuals who possess basic bookkeeping and accounting skills but lack the education or experience to be a member of the professional staff.]

    d. They tend to focus on more difficult projects. [This answer is incorrect. Paraprofessionals may be hired to assist with routine accounting, bookkeeping, and tax engagements, allowing the firm's professional staff time to concentrate on more difficult projects.]

12. The most effective recruiting plans will help a firm do which of the following? **(Page 171)**

    a. Document the hiring plan separately from the recruitment plan. [This answer is incorrect. It is appropriate to document the two types of plans either separately or together. Neither is considered more effective.]

    b. Evaluate all potential candidates in detail. [This answer is incorrect. The hiring process may produce a large number of applicants, particularly in a slow economic climate. Firms can narrow the field of candidates by screening applicants in a nondiscriminatory fashion to identify individuals who appear to possess the desired qualifications. After the pool of potential candidates has been screened, the firm can then evaluate in more detail the candidates who pass the screening process. The firm's recruitment and hiring plans should help the firm with such a screening process, as evaluating unqualified applicants in greater detail is not a good use of the firm's time.]

c. **Present itself to the potential employee in a good light. [This answer is correct. Recruitment in a two-way street. Too often a firm concentrates on evaluating the candidate and forgets to sell the firm. The most effective recruiting plans contain guidelines to assist the interviewer in presenting the firm in a positive light.]**

d. Focus on one or two recruitment methods. [This answer is incorrect. Many techniques can be used to recruit personnel, and the methods used vary, depending on the number of employees being sought and the particular experience level needed. Because of the many recruiting alternatives available, the firm may have a larger pool of candidates to choose from by *not* limiting itself to only one or two techniques in its recruiting plan. In fact, the firm may choose to avoid specifying any particular recruiting techniques.]

13. Which of the following statements most accurately describes an aspect of evaluating prospective employees? **(Page 171)**

a. The evaluation should focus on objective considerations, such as prior work experience. [This answer is incorrect. During the evaluation state, the individual in the firm responsible for hiring makes a judgment of whether or not the candidate possesses the attributes the firm is seeking. In making this judgment, both objective considerations (grade point averages, college courses, prior work experience, etc.) and subjective considerations (personal appearance, responses to questions, general perceptions, etc.) are evaluated.]

b. Evaluation procedures should be kept as vague as possible to allow latitude when hiring. [This answer is incorrect. For small to medium-sized firms, it is a good idea to state evaluation procedures in terms of general guidelines, not specific requirements. However, evaluation procedures also should not be too vague or too unstructured.]

c. **Using a checklist can help the firm present itself professionally. [This answer is correct. To obtain proper structure and yet maintain flexibility, firms can adopt an evaluation checklist to guide the process. Such a checklist helps ensure that a firm presents itself in a formal, structured manner to a potential employee instead of in a disorganized, haphazard manner. The use of a checklist may be incorporated into the candidate evaluation procedures.]**

d. The evaluation process should be the same for all potential candidates to avoid discrimination. [This answer is incorrect. The evaluation process for an individual with prior work experience will be somewhat different than the process for a recent college graduate.]

14. Which of the following is a type of continuing professional development? **(Page 174)**

a. **On-the-job training. [This answer is correct. Continuing professional development has a significant impact on the ongoing competence of the firm's personnel because it facilitates developing and maintaining their technical knowledge and capabilities. Continuing professional development includes activities such as continuing professional education (CPE) and on-the-job training.]**

b. The CPA exam. [This answer is incorrect. Once an individual obtains his or her accounting degree, passing the Uniform CPA examination is often considered to be the next step in their professional education, not continuing professional development.]

c. Work experience. [This answer is incorrect. An individual's past work experience has a significant impact upon his or her capabilities and competence; however, it is a separate consideration from continuing professional development.]

d. The AICPA competency framework. [This answer is incorrect. The AICPA has created a competency framework, detailing the knowledge and skills needed to perform high-quality audit, attestation, review, compilation, and preparation engagements; however, this is a starting off point firms can use for evaluating the competencies and capabilties of their employees. It is not considered part of an individual's continuing professional development.]

15. Which of the following requirements must be met when assigning engagement partners to particular engagements? **(Page 177)**

a. The engagement partner should define his responsibilities for the firm and the supporting engagement staff. [This answer is incorrect. According to QC 10.33, a firm's QC policies and procedures related to engagement teams should require that the *firm* clearly define and communicate to the engagement partner his or her responsibilities.]

b. The engagement partner's identity and role should be communicated to the client's management. [This answer is correct. QC 10.33 indicates that the firm should assign responsibility for each engagement to an engagement partner and should establish policies and procedures requiring that, among other things, the engagement partner's identity and role be communicated to client management and those charged with governance.]

c. The engagement partner must have competence and capabilities to ensure that the firm issues appropriate reports. [This answer is incorrect. QC 10.34 says that firms should establish policies and procedures to assign appropriate staff with the necessary competence and capabilities to enable the firm to issue reports that are appropriate in the circumstances. However, this requirement is for all staff assigned to the engagement, not only the engagement partner. QC 10.33 requires the engagement partner specifically to possess the appropriate competence, capabilities, and authority to perform the role.]

d. The engagement partner must have competence and capabilities to perform engagements that apply with professional standards. [This answer is incorrect. Per QC 10.34, firms should establish policies and procedures to assign appropriate staff with the necessary competence and capabilities to perform engagements that comply with professional standards and applicable legal and regulatory requirements. Such policies and procedures, however, apply to engagement staff as a whole, not solely to engagement partners. Therefore, there is a better answer for this question.]

16. When might an engagement partner want to prepare a formal time budget when assigning staff to an engagement? **(Page 181)**

a. The engagement is for an existing client. [This answer is incorrect. The engagement partner is more likely to use a time budget for a first-time engagement.]

b. The engagement will be short and simple. [This answer is incorrect. A formal time budget is of more use for large, complex, and lengthy engagements.]

c. The engagement is either an audit or a review. [This answer is correct. Preparing a formal time budget is helpful for audit and review engagements because it allows the engagement partner to analyze the time spent in each area.]

d. When it is required by the firm's QC system. [This answer is incorrect. Generally, though there are many good reasons for preparing formal time estimates, the use of such a tool is an optional procedure in a QC system.]

17. Which of the following statements best describes an issue related to staffing the firm's engagements? **(Page 182)**

    a. Once a staffing plan is made, it should stay the same for continuity reasons. [This answer is incorrect. Just as consideration of competencies appropriate for a particular client is an ongoing process, so is consideration of the competencies possessed by the partner and other personnel assigned to a particular engagement. The firm may decide that modification of the staffing plan is necessary after considering the competence and capabilities of personnel assigned to particular engagements.]

    b. The best place to find an experienced third party is in the firm's same geographic area. [This answer is incorrect. One likely place to find a qualified third party is to consider the expertise of other accounting firms outside of your market area. Alternatively, joining a firm network could provide access to qualified third-party expertise.]

    c. Effective QC plans will require that the staffing plan is communicated in a written format. [This answer is incorrect. Communication of the assignments to staff can be accomplished in several ways. In a small firm, the complete master staffing plan may be provided to all staff members. Sole practitioners or small firms with few staff members may choose to communicate staffing assignments orally. A written format is not required.]

    d. Items such as engagement type and size and necessary experience may affect staffing assignments. [This answer is correct. In making staff assignments, consideration may be given to a number of factors. Some examples include (1) the engagement type, size, significance, complexity, and risk profile; (2) special expertise and experience necessary for the engagement; and (3) new or emerging standards and applicable legal and regulatory requirements that may affect the engagement.]

REQUIREMENTS FOR PROFESSIONAL DEVELOPMENT

QC 10 does not stipulate any specific requirements regarding professional development. However, QC 10.A20 indicates that continuing professional development has a significant impact on the ongoing competence of the firm's personnel because it facilitates maintaining or increasing their knowledge and capabilities. Effective policies and procedures emphasize the need for all levels of firm personnel to participate in general and industry-specific CPE and other professional development activities that enable them to fulfill their assigned responsibilities, including passing the Uniform CPA Examination. In addition, such training will satisfy applicable CPE requirements of the AICPA, state boards of accountancy, state CPA societies, and other regulatory agencies.

The firm may provide the necessary training resources and assistance to facilitate the development and maintenance of firm personnel's required competence and capabilities. Alternatively, the firm may use an external source that is suitably qualified for that purpose if the firm has no technical and training resources, or for any other reason.

AICPA Bylaw Requirements

The AICPA bylaws require, among other things, mandatory CPE as a condition for membership. Section 2.3.3 of the AICPA bylaws (AICPA *Professional Standards*, BL Section 230R.04–.07) mandates that AICPA members complete and maintain records for 120 hours, or its equivalent, of CPE for each three-year reporting period. CPE can be obtained from either a formal education program or other means that reasonably maintain professional competencies in the member's area of practice or employment. Annually, members should report compliance with this requirement to the AICPA. Members are also required to maintain appropriate records of CPE completed and submit copies of such if requested by the AICPA. The AICPA Board of Directors (or a body designated or appointed by it) has the final power and authority to identify and accept learning methods that meet and measure the CPE requirement and to grant compliance exceptions.

Statement on Standards for Continuing Professional Education (CPE) Programs

The AICPA *Statement on Standards for Continuing Professional Education (CPE) Programs* (CPE Standards) governs the development, presentation, measurement, and reporting of CPE programs. Firms should be aware of such guidance when developing their QC policies and procedures for professional development. Basic CPE requirements for AICPA members include earning 120 hours of CPE during every three-year reporting period. The standards are found at CPE Sections 100–400 of the AICPA *Professional Standards*, and are the primary basis for the guidance presented in this section. Adopting the AICPA CPE standards is discretionary by each state accountancy board. Accordingly, firms ought to check with their respective state regarding CPE requirements, as well as whether their state accountancy board has adopted the CPE standards provisions discussed in the following paragraphs.

CPE Standards Revision. In August 2016, the AICPA and NASBA jointly issued revised CPE Standards. Updated CPE standards allow the acceptance of nano-learning and blended learning as new types of acceptable CPE. *Nano-learning* refers to information delivered in very small increments, such as 10-minute sessions, that often cover task-specific topics. An example of nano-learning is a short video that could be accessed to master a certain task that a CPA encounters during the work day. Blended learning combines multiple types of CPE, such as live instruction with on-demand self-study. The new standards were effective September 1, 2016. CPE sponsors had until December 31, 2016, to comply with the new guidance for programs under development. All other programs must be in compliance by the next CPE program review or revision date. For more information about these and other changes to the CPE guidance, refer to the AICPA's website at **www.aicpa.org/CPEAndConferences/CPERequirements/Pages/CPERequirements.aspx**.

Types of CPE Programs. Firms may choose from many types of formal CPE programs to meet the professional requirements of their personnel and the firm's needs. One CPE credit equals one 50-minute period. For group, independent study, and blended learning programs, a minimum of one CPE credit (50-minute period) must be earned initially, and one-fifth (10-minute period) or one-half (25-minute) increments can be awarded after the first full credit has been earned. For self-study programs, a minimum of one-half CPE credit (25-minute period) must be earned initially, and one-fifth (10-minute period) or one-half (25-minute period) increments can be awarded after the first full credit has been earned. For nano-learning, programs, credits can only be awarded in one-fifth CPE increments or 10-minute periods. (As of September 1, 2016, blending learning and nano-learning programs are new types of acceptable CPE and are further discussed below.) The following is a summary of the types of CPE generally available:

- *Group Live Programs.* Attending group live programs, such as conferences and seminars, is one of the most popular forms of CPE. It can be an excellent way to learn about selected topics from real-time instructors or subject matter experts (SMEs) in a group setting. Conferences and seminars also allow interaction with other professionals who may have practical insights into problems and solutions that cannot be found in textbooks.

- *Group Internet Based Programs.* Group internet-based programs must be conducted by a real-time instructor or SME while the program is being presented and the program must have built-in processes for attendance and participant interaction with the instructor/SME while the course is in progress (including the opportunity to ask questions and receive answers during the presentation). Satellite conferences (also known as virtual conferences) and webcasts are popular forms of group internet-based programs. These virtual programs provide individual participants with an excellent opportunity for gaining knowledge on a specific topic from a real-time group of leading authorities in the field.

- *Self-study Programs.* Self-study programs are popular because of their low cost and ever-expanding subject matter. Self-study programs are required to elicit participant responses to test for understanding of the material, and the participant must receive a passing grade on a qualified assessment to complete the program and receive CPE credit. Since course materials are available at the practitioner's convenience (as opposed to being available on a set class schedule), the courses are an excellent way to brush up on topics as needed. See further discussion of self-study courses below.

- *Nano-learning Programs. Nano-learning* refers to information delivered in very small increments, such as 10-minute sessions, that often cover task-specific topics. An example of nano-learning is a short video that could be accessed to master a certain task that a CPA encounters during the work day. Nano-learning programs are perfect for individuals in a time crunch. These programs deliver focused content on a clearly defined subject or concept, and participants must receive a 100% score on a qualified assessment to obtain CPE credit. Online tutorials and demonstrations are some common forms of nano-learning programs. These tutorials may be an excellent way to demonstrate how new guidance should be applied when preparing for upcoming engagements. However, the AICPA cautions that nano-learning is not a substitute for comprehensive programs that address complex issues.

- *Blended Learning Programs.* Blended learning programs represent a combination of different learning methods, delivery methods, scheduling, or levels of guidance. For example, combining live instruction with on-demand self-study.

- *In-house Seminars.* In-house seminars (ordinarily group live programs) are a practical, effective, and low-cost way to train staff on basic topics and to keep staff up-to-date on current developments. Many firms provide in-house CPE through monthly or quarterly meetings that cover recent developments and discuss applying the developments to client situations. See further discussion of in-house seminars later in this lesson.

- *Speaker, Instructor, or Discussion Leader of a Course or Conference.* As the saying goes, there is no better way to learn a subject than to teach it. Therefore, being the leader of a CPE course can be helpful in mastering subject areas (as well as communication skills).

- *College Courses.* Graduate level college courses offer structured, detailed training in a particular subject, such as taxation, and can allow participants to earn graduate degrees.

- *Professional Writing.* Professional writing can be an effective method of mastering subject areas. Some states limit the number of writing hours that can be used to meet mandatory CPE requirements.

- *Independent Study.* In rare circumstances, CPAs are faced with unique issues, and pertinent learning materials or CPE courses may not be readily available. The CPE Standards enable CPAs to earn CPE credit for independent study under the direction of a CPE program sponsor who is qualified in the subject matter.

Firms need to review the CPE Standards to ensure that the requirements of each type of CPE are followed. The other types of CPE also have their own requirements that must be met. Requirements related to documentation and retention of CPE are discussed later in this lesson.

State Boards of Accountancy and State CPA Societies

Most state boards of accountancy have some form of CPE requirement for licensing. Most state CPA societies also have a CPE requirement for their members. Although many state requirements are similar to those of the AICPA, they do vary from state to state. For instance, for licensing, some states require that the individual must complete a stated number of CPE hours in accounting and auditing per reporting period. In addition, some state boards specify the maximum number of CPE hours that can be obtained in a particular delivery mode such as self-study, and some state boards do not allow any credit for certain delivery modes (for example, professional writing). Some states require a minimum number of CPE hours in ethics on a recurring basis and may stipulate that in meeting the minimum ethics CPE requirement, courses taken must be provided by specified trainers and approved by the state board of accountancy.

State Acceptance of Self-study CPE Credits. It can be difficult to determine the appropriate CPE credit to claim for a self-study CPE course. CPE credit for self-study learning activities is based on either (a) a pilot test of the average completion time of at least three individuals who are independent of the program development group or (b) a computation using the prescribed word count formula, as defined in the CPE Standards.

Another factor is whether the course is a Quality Assurance Service (QAS) course. QAS refers to a self-study course developed by a course provider registered with the National Association of State Boards of Accountancy (NASBA) as a QAS sponsor. A QAS course must meet requirements developed by NASBA for organizations that offer self-study CPE courses, including compliance with the AICPA CPE standards.

Some courses carry the designation and logo of a NASBA Registry course. NASBA established the National Registry of CPE Sponsors (Registry) to assist state boards in identifying quality sponsors of CPE for program development, presentation, measurement, and reporting in accordance with nationally recognized standards. A Registry sponsor may or may not also be a QAS sponsor. Similarly, a state that accepts the Registry may or may not have accepted the AICPA CPE standards or recognized QAS sponsors. Further information regarding QAS and NASBA Registry courses is available at **www.nasba.org**.

Given the varying requirements of the AICPA and NASBA, the same self-study course may provide a different amount of credit in different states. State boards of accountancy have final authority on the acceptance of individual courses for CPE credit. Firms can check with their state board if any uncertainty exists about the number of credit hours to claim for a self-study course.

Special Considerations—*Government Auditing Standards*

24-hour and 80-hour CPE Requirement. According to Paragraph 3.76 of the Yellow Book, each auditor performing work under the Yellow Book, including planning, directing, performing field work, or reporting on an audit engagement under the Yellow Book, should complete every two years, at least 24 hours of CPE that directly relates to government auditing, the government environment, or the specific or unique environment in which the audited entity operates. In addition, auditors who do any amount of planning, directing, or reporting on Yellow Book audits and auditors who are not involved in those activities but charge at least 20% of their time annually to Yellow Book audits are required to also obtain at least another 56 hours (for a total of 80 hours) of CPE that enhances their professional proficiency to perform audits. In other words, everyone working on a Yellow Book audit has to meet the 24-hour requirement. However, auditors who do not plan, direct, or report on a Yellow Book audit, or who do not spend at least 20% of their time annually on Yellow Book audits, are not required to obtain an additional 56 hours of CPE to comply with the 80-hour requirement. (As mentioned earlier in this lesson, the GAO has issued an exposure draft containing proposed updates to the Yellow Book, some of which would change those Yellow Book CPE requirements. The exposure draft indicates that the effective date for the revision will be included at the time the Yellow Book is issued as final. A future edition of this course will provide more information once the effective date is known.)

CPE Topics that Meet the Yellow Book Requirements. The Yellow Book at Paragraph 3.77 states that determining what CPE subjects are appropriate to satisfy CPE requirements is a matter of professional judgment to be exercised by auditors in consultation with appropriate officials in their audit organization. In deciding appropriate CPE courses, auditors may consider their experience, the responsibilities they have in a Yellow Book audit, and the operating environment of the audited entity.

The Yellow Book at Paragraph 3.78 further states that individual auditors are primarily responsible for improving their own competencies and meeting CPE requirements. However, audit firms should establish quality control procedures to help ensure that auditors meet CPE requirements, including documentation of CPE completed.

The Yellow Book continuing education requirements are discussed in detail in *PPC's Guide to Audits of Local Governments*, *PPC's Guide to Audits of Nonprofit Organizations*, and *PPC's Guide to Single Audits*.

Attestation Engagements. Chapter 5 of the Yellow Book provides guidance that applies to the performance of attestation engagements under the *Government Auditing Standards*. Such attestation engagements are also required to apply to the guidance contained in Chapters 1 through 3 of the Yellow Book. Thus, CPAs who perform such attestation engagements are also required to follow the CPE requirements discussed above.

Implementation Guidance on CPE. In 2005, the GAO issued comprehensive guidance on CPE for auditors who perform Yellow Book engagements. *Guidance on GAGAS Requirements for Continuing Professional Education* (2005 Guidance) clarifies numerous CPE issues including measurement periods, 24-hour and 80-hour requirements, and CPE topics that meet the Yellow Book requirements. The concepts, but not the detailed guidance, have been incorporated into the Yellow Book. The current Yellow Book indicates that the 2005 Guidance is still applicable. Auditors may want to refer to it for identification of acceptable CPE topics. It is available on the GAO's website at **www.gao.gov/products/GAO-05-568G**.

CPE Reporting. Firms are not required to report compliance with the CPE requirements to the GAO or other government agencies. However, individual compliance will be evaluated during the performance of the firm's peer review. (*Government Auditing Standards* require participation in a peer review program.) When firm personnel are found not to be in compliance with the GAO CPE requirements, the peer reviewer will consider the degree of noncompliance and the implications of such noncompliance on the firm's system of quality control. If other governmental engagement deficiencies were noted, or the noncompliance with GAO CPE requirements rises to a level of a deficiency, the firm can receive a peer review report with a rating of *pass with deficiency* related to the human resources quality control element.

AICPA Audit Quality Centers

Governmental Audit Quality Center. The AICPA has created its Governmental Audit Quality Center, which has specific membership requirements. One requirement is that the audit partner designated to have firm-wide responsibility for the quality of the firm's government audit practice must meet the Yellow Book's CPE requirements summarized in the preceding paragraphs, even if the partner would not otherwise be subject to those CPE requirements. Another Center requirement is that the partner participates in the live or archived version of an annual Center-sponsored webcast on recent developments in governmental auditing.

Employee Benefit Plan Audit Quality Center. The AICPA also has its Employee Benefit Plan Audit Quality Center, which has specific membership requirements. One requirement is that the firm establishes a program for ensuring that all ERISA employee benefit plan engagement personnel have appropriate knowledge, through on-the-job training and CPE, of professional standards, rules, and regulations relevant to ERISA audits. Before signing audit opinions or managing ERISA audits, individuals must complete a minimum of 8 hours of CPE specific to employee benefit plans within a three-year period and every three years thereafter as long as the individuals continue in those capacities. The program must be in place at admission to the Center and the CPE requirements must be met in the firm's or individual's first CPE cycle ending after admission date.

Planning the Firm's Professional Development Activities

At least once a year, the person responsible for professional development needs to assess the firm's professional development needs and plan the professional development program. In smaller firms, a partner (or even the managing partner) may be responsible for professional development. However, as the firm grows, this responsibility is often assigned to another individual. Although this course recommends that a partner be in charge of professional development, someone else can perform the duties if given the proper training, supervision, and authority to implement the plans. Regardless of who is responsible, a thorough knowledge of the various CPE requirements affecting the firm, as well as a thorough understanding of the special needs of the firm to appropriately serve its clients, is essential. Planning the firm's professional development program is important if the firm is to accomplish the following:

- *Provide Quality Professional Services.* Competent staff who stay abreast of the technical guidance necessary to perform their engagements are essential to a firm's ability to provide quality professional services. A properly planned professional development program helps the staff maintain such ability.

- *Identify Individual Staff Training Needs.* Staff who have specific training deficiencies need to be identified and training techniques designed to address those deficiencies (i.e., a staff member who lacks good documentation techniques may be assigned to work under a supervisor who is experienced in this area).

- *Specific Industry Training Needs.* When firms add a new client with unique industry accounting requirements, even if a partner in the firm is familiar with the industry, staff often will not be. Accordingly, staff may need industry training to help develop the capabilities and competencies for the specific industry. Some firms have a best practice of requiring partners who are designated with the firm-wide responsibility for the quality of engagements in specialized industries to take annual CPE in the specialized industries. Additionally, firms that are members of the AICPA audit quality centers are required to have the head industry partner take annual specialized CPE, as discussed above.

- *Control CPE Costs.* The CPE needs of the staff can be assessed and met more cost-effectively through planning. Such planning can also help achieve a proper mix of in-house and outside programs that best meet the needs of the firm and its personnel.

- *Develop Specialists or Experts.* Consider the firm's needs for specialists or experts. Identify special courses or reference materials that are needed and take steps to fulfill those needs. Some firms may have a need for managers, partners, and experienced staff with professional certifications in addition to the CPA certification.

Create a Professional Development Plan for Each Professional in the Firm. Planning for a firm's CPE and professional development activities means more than having a policy that requires all professionals to earn a certain number of hours of CPE each year. Creating a professional development (PD) plan that is customized for the unique needs of each professional is generally considered the most effective way to build and maintain an individual's competence and capability. The CPE Standards suggest, but do not require, that CPAs develop a learning plan to help guide their professional development. They further state that learning plans include the following:

- A self-assessment of the gap between current and needed knowledge, skills, and abilities.

- A set of learning objectives arising from this assessment.

- Learning activities to be undertaken to fulfill the learning plan.

Other factors to be considered when planning an individual's PD needs include the following:

- The individual's personal PD desires, i.e., what CPE courses or seminars the individual wants to attend, what skills the individual would like to develop, any specialized industry areas that the individual would like to focus on, etc.

- The firm's assessment of both the individual's PD needs relevant to their responsibilities and the firm's particular needs to stay technically current in a special accounting area or to expand into a new service area.

- The CPE requirements of the AICPA, state boards of accountancy, the GAO, and other regulatory agencies. Those requirements pertain not only to obtaining the minimum CPE hours for each staff, but also ensuring that the professional development courses qualify for CPE credit.

- Encouraging personnel at each staff level to participate in PD activities such as completing external professional development programs, becoming members of professional organizations, serving on professional committees, writing for professional publications, and speaking to professional groups.

Planning the PD needs of each staff member is time consuming. Consequently, this type of planning may be viewed as an onerous and unnecessary task by sole practitioners and small firms, especially if CPE decisions in those firms have been made on an ad hoc basis. While establishing PD plans for each professional is time consuming, it represents the most effective method to ensure that staff members obtain the appropriate CPE to enable them to fulfill their assigned responsibilities and to satisfy applicable CPE requirements of the AICPA, state boards of accountancy, and other regulatory agencies. It is in the firm's best interest to oversee each staff members' PD program following firm guidelines and in subjects that are relevant to each individual's responsibilities. Additionally, as previously mentioned, coordination of CPE activities at the firm level can greatly reduce total CPE costs. Firms may choose to develop the PD plan for new staff and then discuss the plan with them, using the opportunity as a means to teach new staff how to develop their PD plan in subsequent years. Even when staff is preparing the PD plan, firm management needs to review and discuss the PD plan as necessary and give final approval.

Document the Professional Development Plan. Some firms elect to document the professional development planning process in a memo or minutes to a partners' meeting. Normally, partner meeting minutes would indicate in general terms that PD planning has occurred. This documentation approach can be effective for sole practitioners or small firms with only a few professional staff members. When larger firms do not have evidence of a written PD plan for each professional in the firm, however, peer reviewers will normally ask how the firm went about determining CPE needs for each professional. Such a process may require the peer reviewer to interview each staff member in the firm to discuss how that individual's CPE needs were determined and met. Preparing a formal firm-wide CPE planning worksheet would eliminate the need for the peer reviewer to discuss CPE with each professional in the firm. Exhibit 2-7 illustrates how PD planning might be documented in a memo.

Exhibit 2-7

Memo or Minutes Documenting Professional Development Plans

On [Date], [Name(s) of Person(s) Involved] met to (1) evaluate our 20XX/XY professional development activities and (2) develop our 20XX/XY professional development plan.

We discussed planning our professional development activities for the upcoming year. After considering factors such as the CPE activities that interest each professional, the number of CPE hours needed by each professional, the level of experience of each professional, client responsibilities, prior CPE training, new or emerging technical literature, and the firm's needs for specialists, we formulated general guidelines for [Person's Name] to follow in planning and approving the CPE activities of each staff member. [Alternatively, if the firm prepares a formal plan, the committee would approve the plan.]

Next, we discussed special on-the-job training needs of our staff and made plans to address those needs in making next year's job assignments. We also reviewed the need to obtain new additions to our physical and online libraries and agreed to purchase several of those items. [Optionally, you can list those items.]

* * *

An alternative documentation approach, and the one recommended by this course (especially for large firms), is the preparation of an annual CPE planning worksheet for each individual in the firm. Staff may prepare their individual CPE plan and submit the form to management for discussion and approval. This approach has the advantage of allowing the person responsible for CPE planning to formally document the overall PD plan and to fine tune the plan for cost savings or other purposes.

Select and Develop Professional Development Activities That Meet CPE Requirements. In the process of developing a PD plan, a firm can select from a vast array of CPE alternatives, as discussed earlier in this lesson. The

AICPA and each state board of accountancy have guidelines on which CPE alternatives qualify and how to determine credit hours. The AICPA *Statement on Standards for Continuing Professional Education Programs* and state CPE requirements were discussed earlier in this lesson. The AICPA and state societies offer extensive options for CPE, generally through seminars, conferences, and self-study courses. Firms may visit the websites of the AICPA and the relevant state societies for additional information about CPE offerings.

The Tax & Accounting business of Thomson Reuters offers various CPE solutions to practitioners. Courses are delivered in a variety of formats, including online learning, live seminars and conferences, virtual conferences, in-house training, and self-study courses. Specific information about such CPE and training offerings can be found online at **tax.thomsonreuters.com/products/brands/checkpoint/learning-solutions/**. Additionally, PPC provides self-study CPE courses in many of the PPC guides at no charge, except for a nominal grading fee.

The AICPA and the Chartered Institute of Management Accountants (CIMA) jointly developed a competency and learning website that combines the learning, planning, and assessment resources of both organizations into one portal. The site offers a variety of online courses, publications, videos, webcasts, and competency frameworks, including the *AICPA Competency Framework: Assurance Services*, as previously discussed. The website also provides self-assessment tools and knowledge checks to aid practitioners in creating customized learning plans based upon their individual needs and areas of improvements. More information about this joint venture and its offerings can be found online at **https://competency.aicpa.org/**.

NASBA also offers a solution to identifying CPE courses. From NASBA's website at **https://nasba.org**, the "Licensure" and "Education" dropdown menus provide CPAs with information about CPA licensure requirements, maintaining a CPA license, CPE courses, CPE requirements, and more. NASBA's CPE course database is searchable by credit hours, location of course, subject area, date, delivery method, and type of credit, and may be accessed at **www.nasbaregistry.org/**. CPE courses may also be searched by provider name, ID number, and keyword.

In-house CPE Programs. As previously mentioned, one CPE alternative that is very popular because of its practicality, effectiveness, and low cost is in-house developed CPE programs. Certain requirements must be met in order for in-house CPE programs to qualify for CPE credit. Because of these specific requirements, it is a best practice for a firm's QC system to contain special procedures to emphasize the steps necessary to develop and present in-house CPE for which credit can be received. To better ensure that the firm's in-house CPE programs comply with CPE requirements, the firm may consider using a series of checklists, attendance sheets, and rating forms for in-house programs.

New Employee Orientation Seminars. Larger firms may choose to develop a new staff orientation program and conduct an orientation class for new staff members. Such an orientation class can be designed to qualify for CPE credit. New staff orientation can be accomplished in part by requiring new staff to read the firm's QC documents and affirm that they have done so.

Ethics Training. In addition to training new employees about the process involved in performing their new job responsibilities, employees need to be instructed about the firm's values and ethics policies as soon as they are hired. This training needs to clearly explain to all employees what is expected of them with regard to employee responsibility to communicate certain ethics-related matters, the types of matters to be communicated, and how to communicate such matters.

To keep the significance of the firm's values and ethics policies uppermost in the minds of the staff, firms can provide periodic refresher ethics training following the new-hire training. Many states require a minimum number of CPE hours in ethics on a recurring basis and may stipulate that the ethics courses taken be provided by specified trainers and approved by the state board of accountancy. In addition, as previously discussed, independence education for those individuals who are required to be independent assists in developing an individual's competence.

Independent Study Option. In unusual circumstances, CPAs are faced with unique issues, and learning materials or CPE courses may not be readily available. The CPE Standards allow CPAs the option of earning CPE credit through independent study under the direction of a CPE program sponsor who is qualified in the subject matter. The independent study's subject matter and level must maintain or improve the CPA's professional competence, and the sponsor must meet the applicable standards for CPE program sponsors. To earn CPE credit through independent study, the CPA must do the following:

- Enter into a written learning contract with the sponsor. The contract indicates the nature of the program and the time within which it is to be completed (up to 15 weeks), as well as the maximum CPE credit that can be earned (limited to the actual time spent), agreed upon in advance. The required output of the CPA's self-study must be (a) a written report that is reviewed and signed by the sponsor or other qualified person or (b) a written certification by the sponsor that the CPA successfully demonstrated the learning objectives through either completing all tasks or performing a live demonstration, oral examination, or presentation to a subject matter expert.

- Accept the sponsor's written recommendation of the number of CPE credits that can be earned.

- Meet the requirements of the learning contract.

- Complete the independent-study program in 15 weeks or less.

- Retain documentation as necessary to satisfy regulatory requirements as to the content, inputs, and outcomes of the independent study.a

Activities That Meet Requirements of the GAO and the AICPA Audit Quality Centers. The GAO requires that auditors who perform audits under *Government Auditing Standards* meet certain CPE requirements. Also, if the firm is a member of the AICPA Governmental Audit Quality Center, CPE activities of the audit partner designated to have firm-wide responsibility for the quality of the firm's government audit practice must meet the Yellow Book's CPE requirements, as previously discussed. These requirements, which are found in the *Government Auditing Standards*, were summarized earlier in this section. If the firm is a member of the AICPA Employee Benefit Plan Audit Quality Center, CPE activities of all ERISA employee benefit plan engagement personnel must meet the requirements discussed earlier in this section.

Maintain Appropriate CPE Records. An important part of a well-designed professional development QC system is maintaining appropriate CPE records. While it is important for the firm to establish policies that ensure its professionals take appropriate learning activities and the required number of CPE hours, it is the professional's responsibility to maintain appropriate CPE records. Participant CPE reporting and documentation requirements are provided in the CPE Standards, by most state boards of accountancy, and by the GAO. CPAs are responsible for accurately reporting the number of hours of CPE credits earned each period (generally annually) and are required to retain appropriate document of their participation in the CPE learning activities for which they have claimed credit. The CPE Standards indicate that unless differing legal or other requirements exist, it is reasonable for CPAs to retain such documentation for a minimum of five years from the end of the year in which the learning activities were completed. Many state boards of accountancy now provide online tools that a CPA may use to easily track the CPE that has been completed. *PPC's Guide to Quality Control* also provides a form that an individual may use to track his or her CPE.

According to the CPE Standards, the following are examples of acceptable documentation that CPAs can retain to evidence completion of various types of CPE learning activities:

- For group, blended learning, and independent study programs, a certificate or other verification supplied by the program sponsor.

- For a university or college course that is successfully completed for credit, a record or transcript of the grade the person received. (If a noncredit course, a certificate of attendance.)

- For self-study and nano-learning programs, a certificate of satisfactory completion of a qualified assessment provided by the program sponsor.

- For instruction credit, appropriate supporting documentation that complies with the requirements of the respective state boards subject to the guidelines of CPE Section 300.72.

- For published books, articles, or CPE programs, a copy of the publication (a copy of the book, journal, or course development documentation) that names the CPA as author or contributor, the writer's statement supporting the number of CPE hours claimed, and the name and contact information of the independent reviewer(s) or publisher.

Firms that act as CPE program sponsors are required to retain documentation that supports the firm's compliance with the CPE Standards. One requirement is to provide participants with documentation to support their claims of CPE credits. Generally, this is provided by the CPE program sponsor through a certificate of completion (electronic or paper). Pursuant to the CPE Standards, the certificate of completion should include—

- CPE program sponsor name and contact information.
- Participant's name and amount of CPE credit recommended.
- CPE course title, field of study, and type of instructional or delivery method used.
- Date the course was offered or completed, including location (if applicable).
- Verification by a representative of the CPE program sponsor.
- NASBA time statement indicating that CPE credits were granted based on a 50-minute hour.
- Sponsor identification number (issued by the state board) and any other information required by state boards.

As a CPE program sponsor, the firm must retain adequate documentation as evidence of compliance with the CPE standards. The CPE program sponsor maintains documentation including (but not limited to) the following:

- Records that support participation, including dates and locations.
- Author/instructor, author/developer, and/or reviewer names and credentials, including license information (state, status, and license number) for CPAs and tax attorneys and enrolled agent numbers for enrolled agents.
- Number of CPE credits earned by participants.
- Results of program evaluations.
- Program descriptive materials (course announcement information).
- Copies of program materials (e.g., reading materials, problems, case studies, visual aids, instructors' manuals, etc.).
- Evidence that the program materials were developed and reviewed by qualified individuals.
- Record of how CPE credits were determined.

The firm should maintain for five years appropriate CPE program sponsor documentation to support its compliance with the CPE Standards.

Provide Information on Changing Professional Standards in a Timely Manner. A constant challenge for any firm is keeping professional staff knowledgeable and up-to-date with the seemingly constant changes in accounting, auditing, attestation, quality control, and independence standards and requirements, as well as relevant current events. To meet this challenge, most professional development quality control systems contain a procedure requiring the firm to maintain an up-to-date library. The procedure includes communicating and distributing within the firm bulletins, emails, or memos that highlight changes in professional standards and significant business news, and more importantly, the firm's guidance with respect to changing standards and requirements. Large, multi-office firms often have a dedicated group of individuals who prepare and circulate such information to all firm locations. Generally, however, small firms do not have staff consistently available to perform that function and, thus, need to devise some other practical and effective method of disseminating the information.

Determine That the Firm Subscribes to Appropriate Professional and Business Publications. It is important for firms to maintain an up-to-date library that includes professional pronouncements of the organizations, regulatory bodies, and governmental entities that affect the practices of CPA firms. In addition to determining the adequacy of the material contained in the library, the firm needs to also review its current subscriptions to update services, newsletters, etc. In many small firms, library and subscription purchases are determined on an ad hoc basis, resulting in a constant stream of information to be filed in update sources kept in the library or to be circulated through the firm. Rarely does a firm lack in library resources. Instead, the real dilemma is how to determine what to read from the overwhelming influx of material.

Utilize Regular Staff Meetings. Firms may hold regular staff meetings as an effective means to communicate information from firm management or to ensure staff have a regular opportunity to raise questions and concerns. Staff meetings can also be used as an ideal time to highlight recent changes to requirements or standards. Such information is not limited to accounting alone, but can include payroll, state requirements, tax, ethics, quality control, etc. Discussing recent changes with the staff provides an opportunity for them to ask clarifying questions, if needed, and gives firm management a convenient venue to explain how the new requirements or standards will affect existing clients.

Develop a Circulation System. There is not one best method for circulating update material and important news through an office. However, many firms have found that a system similar to the following is effective. (Many of the following procedures may alternatively be accomplished electronically, as explained further at the end of this paragraph.)

a. Prepare a distribution list that shows the names or initials of individuals in the firm to whom technical updates should be delivered.

b. Assign someone the responsibility for maintaining library updates.

c. Have the individual copy any summaries that accompany the update materials; for example, the first page of a new pronouncement often contains a summary of key points. This copy can be circulated throughout the firm using the routing system.

d. Firms that prefer to circulate information electronically to the extent possible may choose to subscribe to various electronic newsletters, many of which are free of charge. A subscription can be set up for each professional employee so that the electronic information goes directly to each individual's computer. Additionally, many specialized industries and accounting organizations provide newsworthy information on their websites.

e. Circulate a copy of the *Journal of Accountancy* (the *Journal*) to all professionals in the firm. The *Journal* covers a variety of subjects including accounting, financial reporting, auditing, taxation, personal financial planning, technology, business valuation, professional development, ethics, liability issues, consulting, practice management, education, and related domestic and international business issues. The *Journal* is available electronically at **www.journalofaccountancy.com**.

f. Circulate important newsletters through the firm.

g. Encourage personnel in the firm to bring to the attention of the managing partner or supervisor any news item believed to be important.

h. As the firm grows in size, delegate the responsibility for reading important publications to qualified professionals in the firm. Those individuals can clip, photocopy, or otherwise tag important articles for circulation. Also, consider having that individual note what portion of the article is important so that reading time by others may be minimized.

i. After the information has been distributed throughout the firm, file in the library or archive electronically. Consider maintaining important news in a subject file once it has been circulated through the firm.

For firms that have migrated to primarily electronic-only distribution of update material and important news articles, the information in the preceding list can be used with only slight modification. For example, electronic distribution lists can be created for the various types of information circulated throughout the firm with each distribution list targeting specifically the individuals who need to review such information. And, as previously mentioned, most newsletters, periodicals, etc., are available in electronic format. Instead of circulating a hard copy of the limited information that is not available electronically, such information can be scanned or saved as a .pdf document and then routed electronically.

Provide On-the-job Training. On-the-job training is one of the most important professional development activities, and it is especially crucial for newly hired staff members with no professional work experience. Unfortunately, because of its informal and unstructured nature, its importance is often overlooked. On-the-job training allows the specific needs of firm personnel to be addressed on an individual basis. On-the-job training can partially address assigning personnel to engagements, as previously discussed. When firms assign its personnel in a manner that allows them to work in a variety of engagement areas and industries and with different supervisors, the firm helps build its personnel's practical experience. Even in smaller firms that may not have the variety of engagements and availability of many different supervisors, the firm can still allow its personnel to work on a variety of clients to build practical experience.

Firms can benefit by training all employees, including paraprofessional and administrative staff. Having skilled employees at all levels of the firm assists in making the firm more efficient and productive. The training of paraprofessionals and administrative staff can often be accomplished by performing effective orientation training when the employee is new, followed by comprehensive on-the-job training to ensure those individuals know how to properly perform their jobs. Paraprofessionals may require more supervision for longer periods of time, as compared to professional staff, when initially performing write-up or tax preparation services.

On-the-job training includes providing timely feedback as an engagement progresses. If possible, provide formal evaluations at the end of each major engagement, or at least annually. Information about evaluating staff is provided below.

PERFORMANCE EVALUATIONS, COMPENSATION DECISIONS, AND EMPLOYEE ADVANCEMENT

QC 10 Requirements

QC 10.32 states that a firm's quality control policies and procedures should provide that personnel selected for advancement have the qualifications necessary to fulfill the responsibilities they will be expected to assume.

Through the use of performance evaluation, compensation, and advancement procedures, the firm gives due recognition and reward to the development and maintenance of competence and commitment to ethical principles. To develop and maintain employee competence and commitment to ethical principles (including a commitment to quality), firms may take the following steps:

- Ensure that the firm's expectations for professional personnel to exhibit quality-focused performance and adherence to professional standards and ethical principles are clearly communicated.
- Provide personnel with performance evaluations and counseling specific to their individual progress and career development.
- Ensure that personnel understand—
  - •• The quality of an individual's performance and adherence to professional standards and ethical principles directly affects compensation and advancement to positions of greater responsibility.

- •• An individual's failure to comply with the firm's policies and procedures may result in disciplinary action.

Generally, the size and circumstances of the firm determine the structure of the firm's performance evaluation process. While it is acceptable for smaller firms to use less formal methods of evaluating the performance of their personnel, the above points are valuable considerations to incorporate even in a less formal process.

Making Personnel Aware of Performance Expectations

Firm personnel can only work toward meeting the firm's expectations regarding performance and ethical principles when those expectations are clearly communicated by the firm. Most firms have specific expectations in the areas of job performance and behavior, standards of quality, and employee development. Too often, however, a firm assumes that its expectations have been communicated to employees (or the firm's expectations are obvious to employees) when they have not. Firms may use a combination of the following methods to communicate performance criteria and expectations to employees:

- *Orientation and Training Programs.* Such programs generally convey the tasks employees are expected to perform and the performance standards the firm will apply.

- *Employee Handbooks.* An employee handbook can effectively communicate how employees are expected to conduct themselves while on the job and the consequences of noncompliance. Firms that use employee handbooks generally present that information to employees at the beginning of their employment because that document includes criteria that will impact the performance evaluation process.

- *Written Job Descriptions.* Job descriptions are particularly effective in expressing expectations about recurring job tasks. To better ensure that employees understand the requirements of their positions, firms need to provide a copy of the job description that relates to each professional's current job position at the time the employee begins that job position.

- *Supervisory Counseling On-the-job.* A frank and prompt response that acknowledges weak or strong performance is one effective method of conveying the firm's expectations. It can also be an invaluable method of correcting minor problems before they become major problems. Many firms adopt policies to ensure that counseling is provided at critical times throughout the year, such as at the end of a training period or an engagement that exceeds more than a specified number of hours. Additionally, firms need to clearly communicate the consequences of failure to follow the firm's policies and procedures regarding performance quality and commitment to ethical principles.

Expectations are more clearly expressed if they are specifically defined and measurable. For example, setting a goal of *showing more initiative* is too broad for many employees to address. However, setting a goal of *taking initiative by proposing a solution to every problem you bring to your supervisor* is more specific and allows an employee's performance to be more fairly measured.

Providing Performance Evaluation and Counseling

The primary objective of a performance evaluation system is to give employees objective counseling on a timely basis. While there are many techniques and approaches to evaluating professional staff, many CPAs use a standard checklist to guide them through the evaluation process. Accordingly, before writing a procedure for this QC step, it is a best practice for the firm to first design or adopt an evaluation form with which both the partners and staff are comfortable.

Selecting a Staff Evaluation Form. At a minimum, an effective staff evaluation form generally covers the following evaluation criteria:

- Professional skills (judgment, ability to supervise, relations with client, etc.).

- Competency and technical skills.

- Personal characteristics.
- Potential for advancement.
- Suggestions for improvement.

Providing employees, at the beginning of the performance review cycle, with a copy of the evaluation form that will be used for their next formal evaluation, is another way in which the firm can clearly express its expectations. Evaluation forms ordinarily include employee qualifications related to performance quality and compliance to ethical principles. Firms need to ensure that other specific performance criteria that is included on job description forms be addressed in the related evaluation form.

Examples of Evaluation Forms. There are many excellent professional staff evaluation checklists that can be adopted by the firm. Both *PPC's Guide to Quality Control* and *PPC's Guide to Managing an Accounting Practice* offer such checklists.

Evaluating Administrative Staff. While the quality control system is limited to professional staff, the firm ought not to ignore providing timely evaluations and advancement decisions to administrative staff. Whatever evaluation form the firm decides to use can be adapted to evaluate those employees.

Determining the Frequency of Evaluations. Although the frequency of evaluations varies among firms, many firms annually conduct formal evaluations, with interim evaluations conducted quarterly, semi-annually, or at the completion of an engagement on which the employee worked over a specified number of hours (for example, 120 hours). Many QC documents stipulate in the evaluation procedure step, a requirement that professional employees be evaluated at a specified frequency. If the firm chooses to stipulate the frequency of professional staff evaluations, it is a best practice to select a frequency that is realistic for those expected to prepare and conduct the evaluations. This course suggests that each professional receive a performance evaluation annually, at a minimum. Obviously, the more frequent the evaluation, the more timely the feedback. However, providing more frequent evaluations necessitates more administrative time. The best solution to determining the frequency of performance evaluations is to set evaluation time intervals that provide an appropriate amount of counseling without being too administratively burdensome to supervisors.

Interim Recognition of Performance. If firms wait until scheduled performance evaluations to point out exceptional or unacceptable performances, one of the most meaningful opportunities to provide encouragement, or correct the noted deficiencies and improve current performance, will be missed. Immediate feedback is also important for employee morale because staff members are always interested in knowing how they are doing. Frequent and prompt feedback is especially important to young professionals, who have grown up receiving constant positive reinforcement and recognition. These young professionals expect to be told how they are performing and they may resent a work environment that does not provide such feedback.

Evaluating Partner Performance. From a theoretical point of view, the partners in many firms readily agree about the importance of conducting partner evaluations. However, from a practical standpoint, conducting such evaluations can be problematic. A primary concern of firm partners with actually performing evaluations of one another is the potentially negative effect such a process can have on partner morale and on their personal relationships. Accordingly, in most small firms, it is unusual for partners to participate in a formal evaluation process. However, many medium-sized and larger firms have found that, when performed in a tactful and constructive manner, partner evaluations can become an accepted part of a firm's performance evaluation, compensation, and advancement QC system. Apart from the quality control benefits of partner evaluation, some firms believe such evaluations are essential to formulating a fair and equitable allocation of firm profits to partners. Partner evaluations also provide a means by which firms can periodically assess that partner responsibilities and compensation do not reward commercial considerations over the quality of work performed. Finally, note that QC 10.A22 suggests performing evaluations for all personnel, not just staff.

One widely used evaluation method is to have each partner complete both a self-evaluation and an evaluation of all other partners in the firm. Those evaluations are normally routed to the managing partner, who compiles the results and discusses the evaluations with each partner. Likewise, an appointed partner or a committee of partners compiles all the managing partner's evaluations, including the self-evaluation, and discusses them with the managing partner.

Emphasis on Quality. Firms can promote a culture of quality by establishing policies and procedures to ensure that the way a firm evaluates, compensates, and promotes its personnel reflects the objectives of the firm's system of quality control. One method to accomplish this is by including performance criteria on evaluation forms to address the firm's stated quality objectives. For example, forms used to evaluate partner performance may include criteria that address whether the partner's actions and behavior support the firm's stated quality objectives. This serves to ensure that partners are held accountable for deficiencies in meeting professional standards and legal and regulatory requirements, and complying with the firm's QC policies and procedures.

In establishing compensation and advancement criteria for partners and other high-level professional staff, the firm ought to incorporate quality-related items, as such as the following:

- The results of firm monitoring, peer reviews, and regulatory inspections and the extent to which the individual participated in the related engagements.

- Identifying, addressing, and appropriately applying significant accounting and auditing technical guidance.

- Adequately communicating with engagement quality control reviewers and resolving any identified issues in a timely manner.

- Consulting appropriately with designated firm experts when challenging issues arise.

Progress and Career Development. The evaluation process is the ideal venue for discussing each employee's progress and career development. Firms that conduct performance evaluations once a year need to discuss such topics as part of that annual evaluation. Firms that conduct performance evaluations more frequently than twice a year, may choose to limit the discussion of progress and career development to a semi-annual frequency. Progress and career development discussion may include past performance, future objectives of the individual and the firm, the individual's preference for engagement assignments, and career opportunities.

Helping Personnel Understand How Quality and Ethics Affect Compensation and Advancement

To most effectively communicate a firm's expectations regarding performance and ethical behavior, as previously discussed, the firm ought to clearly articulate how the linkage between achieving or not achieving the firm's expectations can impact an employee's compensation and advancement to positions of greater responsibility and authority.

In order to effectively discuss compensation and advancement, the firm needs to have an established structure in place for—

- What the firm's performance expectations are for periodic salary increases that are not related to an employee's advancement.

- What criteria needs to be met before an individual is considered for advancement to the next level of responsibility.

Making compensation and advancement decisions is discussed later in this lesson.

Establish Personnel Classification Levels That Describe Responsibilities and Qualifications for Advancement. Firms often establish various personnel classification levels and their corresponding responsibilities. Careful consideration needs to be given to establishing such levels because the criteria that is established will be used for evaluating personnel at each professional level and for advancement to the next higher level of responsibility. Larger firms generally establish more personnel classification levels than is needed for smaller firms with fewer employees. For example, for some very large, departmentalized firms, extensive classifications might prove useful, while for many local firms, fewer classification levels may be more realistic to meet the needs of the firm's operations. The following classification levels of professional personnel seem to be appropriate for a small firm:

- Paraprofessional and intern.
- Staff accountant.
- Senior accountant, often known as in-charge accountant.
- Manager, also known as supervisor.
- Partner.

Documenting Personnel Classifications and Responsibilities. Documenting the personnel classification levels and job responsibilities of professional personnel can be time-consuming. However, such documentation is one way that a firm can help to ensure that its expectations regarding performance and ethical principles are clearly communicated to personnel. When creating such documentation, a clear description of the responsibilities and the attributes necessary for advancement to each classification level need to be included. Criteria providing recognition and reward for developing and maintaining competence and commitment to ethical principles also need to be included.

Firms that use a personnel manual may desire to present the documentation of professional personnel classifications and responsibilities in that manual. If such an approach is followed, the procedure in the QC system that discusses staff classifications would refer to the personnel manual.

Certain sole practitioners or partners in small firms may decide not to expand their practices beyond a certain size. Consequently, those firms may not intend to promote a current staff to the partner level or beyond a certain staff classification level. Those practitioners may choose to limit the number of staff classification levels in the firm to two or three levels (for example, only staff accountant and senior accountant). In such a circumstance, the responsibilities and job descriptions of the limited number of staff classification levels may be expanded.

Communicating Compensation and Advancement Criteria, Policies, and Procedures to the Staff. Some practitioners prefer the use of a personnel manual or other means to communicate the compensation and advancement criteria policies and procedures. However, this course suggests that it is not necessary to include a separate step requiring this communication because the QC document, once read by the staff, accomplishes the communication (either because the QC document refers to the personnel manual or because the compensation and advancement policies and procedures are a part of the human resources QC document).

Making Compensation and Advancement Decisions. At least annually, it is a best practice for the partners (or in a very large firm, a committee of partners) to meet to specifically discuss compensation, advancement, and if necessary, termination decisions. In anticipation of the meeting, provide the current period staff evaluations to partners in advance of the formal compensation and advancement session. How far in advance depends upon the workload of the partners. Ideally, partners need sufficient time to review each performance evaluation and note any comments or questions about that staff member. Those evaluations will provide the bulk of the information relating to the quality of a staff member's performance and professional abilities.

There are a number of questions relating to progression within personnel level classifications that may need to be answered, such as the following:

- Has the individual demonstrated adequate progress in fulfilling the responsibilities of his or her current position, including complying with and embracing the firm's commitment to quality, as well as demonstrating appropriate competence and capabilities?
- Does firm management believe that the individual being promoted has the qualifications necessary for fulfilling the responsibilities of the new position he or she will be expected to assume? It is vitally important to the continuing quality of the firm's engagements that employees not be promoted into positions before they have demonstrated the requisite competence and capabilities.

- For advancement considerations, is there a position available at the appropriate level that the deserving individual can be moved into? It is probably less frustrating for an employee deserving a promotion to be told that advancement will occur as soon as the position becomes available than it is for that individual to be promoted but not assigned the responsibilities of the new position.

A discussion of compensation and advancement decisions also needs to consider current economic conditions. For example, in difficult economic times or if the firm has recently lost one or more major clients, it may be faced with making hard decisions relating to delaying salary increases and some deserved promotions. In this type of environment, the firm may consider providing employee rewards that do not cost the firm a lot of money, such as extra time off or firm lunches, to help sustain employee morale during difficult economic times. (*PPC's Guide to Managing an Accounting Practice* provides additional information about sustaining employee morale.) When the firm is enjoying positive economic conditions, the firm may need to increase compensation and accelerate advancement to retain its top performers.

Documenting Compensation and Advancement Decisions. Many firms annually prepare a short memo for each employee that documents changes in compensation and/or advancement. (Any termination decisions would also be documented.) Alternatively, a firm may use a standard form to document such decisions (*PPC's Guide to Quality Control* provides an example of such a document). Whatever method is used, file the documentation in the employee's personnel file.

Consideration of employment laws and/or firm liability is as important as quality control when documenting advancement and termination decisions. Practitioners for whom this is a concern may wish to consult with their attorney for guidance. In addition, *PPC's Guide to Managing an Accounting Practice* provides further guidance on various liability and legal issues surrounding employee advancement and termination decisions. That *Guide* can be ordered by calling (800) 431-9025 or online at **tax.thomsonreuters.com**.

DRAFTING QC POLICIES AND PROCEDURES

For some of the elements of quality control, professional standards will contain considerations or requirements that should be incorporated into the design of the quality control system. Therefore, it is always important to begin the design of any of the quality control elements with a review of the professional standards. However, for the human resources element, many of the requirements are contained in QC 10. Additional professional standards include the following:

- Certain audit and attestation and *Government Auditing Standards* requirements relating to assigning personnel to engagements.

- AICPA CPE Standards, state boards of accountancy, state CPA societies, and *Government Auditing Standards* all impact the CPE component of professional development.

- Additional CPE requirements exist for firms that are members of the AICPA Governmental Audit Quality Center or the AICPA Employee Benefit Plan Audit Quality Center.

AICPA QC and Peer Review Materials

AICPA Practice Aid. The AICPA suggests the use of its *Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice* (the AICPA Practice Aid) as a means to help practitioners develop the policies and procedures that comprise a firm's system of quality control. The AICPA Practice Aid includes illustrative policies and procedures, as well as tips, warnings, and reminders that firms can use to implement the policies and procedures. After reviewing authoritative literature, this course recommends that the illustrative examples found in the AICPA Practice Aid for designing the human resources element of the quality control system be considered.

Exhibit 2-8 is based on a section from the illustrative example quality control policies and procedures for small and medium-sized firms included in the AICPA Practice Aid. This section contains example policy statements, followed by example procedures that can be used in designing and documenting a firm's human resources quality control system. Example policies are in bold type, example procedures are in regular type, and potential suggested descriptions are in italics.

Exhibit 2-8

AICPA Illustrative Quality Control Policies and Procedures for Human Resources

1. **The firm has sufficient personnel with the competence, capabilities, and commitment to ethical principles necessary to perform engagements in accordance with professional standards and applicable legal and regulatory requirements and enable the firm to issue reports that are appropriate in the circumstances. (See paragraph .31 of QC section 10.)**

2. **The firm hires only personnel that have the characteristics to enable them to perform competently.**

   - An individual in the firm [*name or title*] is responsible for the firm's hiring and human resources management, including evaluation of personnel needs; establishment of hiring objectives based on factors such as existing clientele, anticipated growth, personnel turnover, and individual advancement; and providing final approval.

   - The firm has a process to identify personnel needs at all levels for use in hiring.

   - The firm has hiring criteria which address the following:

     - The attributes, achievements, and experiences desired in entry-level and experienced personnel to enable them to perform competently within the firm.

     - How the firm evaluates personal characteristics such as integrity, competence, and motivation of new hires.

     - Any additional information the firm requires for experienced hires, such as background checks and inquiries about any outstanding regulatory actions.

   - The firm identifies sources of employment candidates, such as universities and executive recruiters.

   - The firm has criteria for determining which individuals will be involved in the interviewing and hiring process.

   - Individuals who will be interviewing candidates or otherwise participating in the hiring process are trained in interviewing techniques.

   - The firm evaluates the results of the hiring process for each candidate, including approval by the managing partner or a person designated by the managing partner of all hiring decisions, in accordance with applicable legal and regulatory requirements.

3. **The firm determines capabilities and competencies required for an engagement, including those required of the engagement partner. (See paragraph .33 of QC section 10.)**

   - The firm specifies the knowledge, skills, and abilities (competencies) that the engagement partner for each of the firm's accounting, auditing, or attestation engagements (the partner or other person who is responsible for supervising those types of engagements and signing or authorizing someone to sign the accountant's report on such engagements) should possess to fulfill his or her engagement responsibilities.

   - Such competencies for the practitioner-in-charge include the following:

     - An understanding of the role of the firm's system of quality control and the AICPA Code of Professional Conduct.

  - An understanding of the performance, supervision, and reporting aspects of the engagement.

  - An understanding of the applicable accounting, auditing, or attestation professional standards, including those standards directly related to the industry in which a client operates.

  - An understanding of the industry in which a client operates, including the industry's organization and operating characteristics, so as to identify the areas of high or unusual risk associated with an engagement, and to evaluate the reasonableness of industry-specific estimates.

  - Skills that indicate sound professional judgment, including the ability to exercise professional skepticism.

  - An understanding of how organizations are dependent on or enabled by information technologies, and the manner in which information systems are used to record and maintain financial information.

4. **The firm determines the capabilities and competencies possessed by personnel. (See paragraph .34 of QC section 10.)**

   - The firm evaluates personal characteristics such as integrity competence, and motivation of personnel on an ongoing basis.

   - The firm periodically evaluates all personnel, including owners, who sign reports on behalf of the firm to assess whether they possess the knowledge, skills, and abilities (competencies) necessary to enable them to be qualified to perform the firm's accounting, auditing, or attestation engagements (for example, by means of coaching, peer evaluation or self-appraisal).

5. **The firm assigns responsibility for each engagement to an engagement partner. The identity and role of the engagement partner are communicated to management and those charged with governance; the engagement partner has the appropriate competence, capabilities, and authority to perform the role; and the responsibilities of the engagement partner are clearly defined and communicated to that individual. (See paragraph .33 of QC section 10.)**

   - Responsibility for each engagement is assigned to an engagement partner who has the appropriate capabilities, competence, authority, and time to perform the role.

   - The identity and role of the engagement partner are communicated to management and those charged with governance at the beginning of the engagement.

   - The responsibilities of an engagement partner are clearly defined by the firm and are communicated to the engagement partner.

   - The partner responsible for partner assignments monitors the workload and availability of engagement partners to enable these individuals to have sufficient time to adequately discharge their responsibilities.

   - When an engagement is found to be materially non-conforming after report issuance (for example, through firm monitoring, peer review or regulatory inspection), the firm

     - requires the engagement partner to take appropriate training and monitors that person's performance (for example, through EQCR) until the firm is satisfied that remediation has occurred;

     - limits or prohibits the engagement partner's assignments on future engagements in that industry or area; or

     - dismisses the engagement partner from the firm.

6. **The firm assigns appropriate personnel with the necessary competence and capabilities to perform engagements in accordance with professional standards and applicable legal and regulatory requirements and enable the firm to issue reports that are appropriate in the circumstances. (See paragraph .34 of QC section 10.)**

    - The firm assigns personnel (including partners) to engagements based on the knowledge, skills, and abilities required in the circumstances and the nature and extent of supervision needed.

        - The firm designates a responsible party(ies) for the assignment of personnel to engagements, including partner and manager assignments.

        - The firm considers each of the following factors to determine how personnel are assigned to engagements:

            - Engagement size and complexity
            - Specialized experience or expertise required
            - Personnel availability and involvement of supervisory personnel
            - Timing of the work to be performed
            - Continuity and rotation of personnel
            - Opportunities for on-the-job training
            - Previous knowledge
            - Skills and abilities [competencies] gained through other experience
            - Situations in which independence or objectivity concerns exist.

    - Approval of partner and manager assignments from the managing partner or other partner is required in the case of high-risk or significant client engagements.

    - The firm assures that individuals are maintaining the appropriate licenses to perform their assigned engagements, including for states other than where the individual primarily practices public accounting.

    - When the firm accepts an audit in an industry in which the firm's personnel do not have recent experience, the firm consults appropriate resources (for example: literature, the AICPA Technical Hotline, or a suitably qualified external person) to determine the extent of changes relevant to the engagement. When determined to be necessary, the firm engages a suitably qualified external person to assist with the performance of an audit as a member of the engagement team.

    - The firm maintains the appropriate firm license(s) or permit(s), including for states other than where its main office is domiciled.

    - In all states where the firm practices, the firm:

        - is licensed under the same name(s) under which it practices,

        - must obtain license(s) or permit(s) which are effective before any reports are issued in the state,

        - considers variations in licensing bodies' rules and regulations and how they affect the firm's need to be licensed in that state; and

        - addresses any restrictions on practice imposed by the licensing bodies.

7. **Personnel, including partners, participate in general and industry-specific continuing professional education (CPE) and professional development activities that enable them to accomplish assigned responsibilities and satisfy applicable CPE requirements of the AICPA, state CPA societies, state boards of accountancy, and other regulators.**

    - The firm has an individual or individuals responsible for the firm's CPE and professional development activities, including maintaining CPE records and course materials for personnel.

    - The firm encourages personnel to pass the Uniform CPA Examination and covers the cost, including paid time off to take the exam.

    - The firm has an orientation and training policy for new hires.

    - The firm informs personnel of their responsibilities and professional opportunities.

    - The firm provides CPE to personnel in subjects that are relevant to their responsibilities, either through in-house programs or externally developed courses.

    - [*If the firm practices in a specialized industry*] a partner is designated with firm-wide responsibility for the quality of the firm's practice in [name the specialized industry]. That partner is required to take annual CPE in the specialized industry.

    - All personnel must comply with the professional education requirements of the board(s) of accountancy in state(s) where they are licensed and, as applicable, the AICPA, the state CPA society, and *Government Auditing Standards*—the Yellow Book.

    - The firm establishes CPE requirements for professional personnel. Under these requirements—

        - all professional personnel must participate in CPE and professional development activities that support their performance in their assigned engagements and are appropriate when considering their role in the firm.

        - If an individual signs opinions on, performs engagement quality control review for, or manages engagements in a specialized industry or area, the individual must have a minimum of eight hours of CPE specific to the industry or area every three years (or within the firm's or individual's CPE period covering a three-year period).

        - All personnel must take ethics CPE periodically [*specify the period—for example, the minimum required by state law or regulation*].

    - The firm reimburses personnel who are CPAs for membership in a state society and the AICPA, including AICPA section memberships, as relevant.

    - The firm informs personnel of changes in accounting and auditing standards, independence, integrity, and objectivity requirements and the firm's technical policies and procedures with respect to them (for example, by distributing technical pronouncements and holding training courses on recent changes and areas noted by the firm as needing improvement).

    - The firm encourages personnel to participate in professional development activities, such as taking graduate-level courses, becoming members of professional organizations, serving on professional committees, speaking to professional groups, and writing for professional publications.

8. **Personnel selected for advancement have the qualifications to fulfill the responsibilities they will be called on to assume. (See paragraph .32 of QC section 10.)**

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

     - Establishing criteria for evaluating personnel at each professional level and for advancement to the next higher level of responsibility. Such criteria give recognition and reward to the development and maintenance of competence and commitment to ethical principles.

     - Informing firm personnel about the criteria for advancement to the next higher level of responsibility.

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

   - The [*director of human resources (specify designated person(s)*)], is [*or are if applicable*] responsible for making advancement and termination decisions, including identifying responsibilities and criteria for evaluation at each level and deciding who will prepare evaluations.

   - The firm designates who is responsible for periodically evaluating the performance of personnel at each level and advising them of their progress in the firm.

   - Periodically [*Specify the period—for example, at least annually or at the conclusion of engagements that last at least three weeks*], the firm reviews with personnel the evaluation of their performance, including an assessment of their knowledge, skills and abilities (competencies), and progress with the firm. The discussion addresses performance, future objectives of the firm and the individual, assignment preferences, and career opportunities.

   - The firm establishes compensation and advancement criteria for partners and other high-level staff that address—

     - feedback based on monitoring results, peer reviews and regulatory inspections;

     - appropriate identification of significant and emerging accounting and auditing issues; and

     - appropriate consultation with firm experts when challenging issues arise.

* * *

While the AICPA's illustrative policies and procedures may provide a logical starting point for designing the human resources quality control system, the firm's needs should be considered before the illustrative policies and procedures are adopted. Firms may find that the AICPA example policies and procedures do not fully meet their firm's particular needs. In fact, introductory information in the AICPA Practice Aid states that firms *may consider* establishing and implementing the illustrated policies and procedures. They are not meant to be all-inclusive, and firms are not limited to using only them. Not all of the example policies and procedures will be applicable to every firm; any nonrelevant policies and procedures need to be eliminated, while other policies and procedures may need to be added. A firm's documented quality control system needs to be tailored for the policies and procedures that are appropriate for the particular firm.

AICPA *Peer Review Program Manual*. The PRPM provides a questionnaire that the peer reviewer completes during the planning phase of the review to evaluate the design of the firm's quality control policies and procedures. Section 4600 of the PRPM presents the questionnaire for firms with two or more personnel. Section 4500 of the PRPM provides the questionnaire for a sole practitioner with no personnel. Practitioners involved in designing a QC system for human resources can read the PRPM quality control policies and procedures questionnaire for their firm size. The AICPA also recommends that firms review these questionnaires as doing so may indicate the need for changes to the firm's written quality control policies and procedures. The questionnaires are available on the AICPA's Enhancing Audit Quality Initiative resources web page at **www.aicpa.org/interestareas/privatecompaniespracticesection/qualityservicesdelivery/keepingup/pages/invigorate-the-focus.aspx#quality**, beneath the "Quality Control & Peer Review" heading. Access to these questionnaires is restricted to AICPA members.

Developing Human Resources Policies and Procedures

Quality control policies are designed to achieve the overall objectives of the QC system and the specific objectives of the individual QC elements. Quality control procedures are designed to provide the actions necessary to implement and monitor compliance with the stated policies. Factors such as the following could impact the QC policies and procedures for a given firm—

- The size of the firm.
- The number of firm locations.
- Operating characteristics of the firm.
- The knowledge and experience of firm personnel.
- The nature and complexity of the firm's practice, including whether it is part of a network.

There is more than one way to develop a firm's quality control policies and procedures. For example, this course develops one policy statement for each QC element or major section and then designs appropriate procedures for each element that implements that one policy. Alternatively, the AICPA Practice Aid provides illustrative policies and procedures that include multiple policy statements for each QC element, with procedures related to each policy. Firms can choose an approach in developing QC policies and procedures that meets the unique needs and desires of the firm.

Initial Considerations Relating to Developing Policies and Procedures for Recruitment and Hiring

Sole practitioners and small firms may not feel a pressing need to develop a system of QC policies and procedures relating to recruitment and hiring because their personnel needs are relatively easy to comprehend and administer. Nevertheless, QC 10 indicates that the firm's policies and procedures related to human resources include recruitment and hiring (among other personnel issues). Obviously, however, sole practitioners without professional personnel would have no need to establish such policies and procedures. Key considerations to remember while designing policies and procedures for recruitment and hiring include the following:

- *General Guidelines Are Best for Small Firms.* Avoid stipulating specific requirements or attributes that potential new employees be required to possess, for example, certain grade point averages or degree requirements. While all firms would like to hire the perfect employee, rarely does that individual exist. Generally, only large firms seeking to narrow the field of candidates to a workable level use recruitment and hiring procedures that stipulate such specific requirements or attributes. Using general guidelines for recruitment and hiring, versus specific requirements, can provide firms with flexibility that may be needed to recruit and hire, especially when a limited pool of qualified candidates is available.
- *Use Standard Checklists.* Many of the documentation requirements of a recruitment and hiring system can be minimized by using a standard interview and evaluation checklist, such as those provided in *PPC's Guide to Quality Control*.

Initial Considerations Relating to Developing Policies and Procedures for Professional Development

Most firms recognize the need to adopt professional development policies and procedures not only because of the importance of staying technically current, but also to comply with quality control standards and mandatory CPE requirements. Additionally, the professional development activity of a QC system is one of the areas examined in peer reviews.

When designing a QC system to address professional development, firms can consider the following:

- *Professional Development Covers More Than CPE.* Too often professional development is thought of only in terms of CPE. However, the QC standards cover all activities that enable a firm to provide personnel with the knowledge and capability needed to fulfill their assigned responsibilities and to progress within the firm. While CPE is a significant component of professional development, keeping up-to-date with changes in professional standards and on-the-job training are also important components of a well-designed professional development QC system.

- *Consider Other Regulatory Requirements.* CPE rules of governing bodies such as the U.S. Government Accountability Office, who establishes the requirements that apply to all accountants who work on audits subject to the *Government Auditing Standards*, and professional organizations such as the AICPA Governmental Audit Quality Center and the AICPA Employee Benefit Plan Audit Quality Center, may have more stringent CPE requirements than those of QC 10. Accordingly, a firm's policies and procedures should also address professional development requirements of other governing bodies or professional organizations, if any.

- *Recognize That Maintaining a Professional Development QC System Can Be Time-Consuming.* It is difficult to avoid the reality that maintaining a professional development system can be time-consuming and costly. Firms, regardless of size, are required to plan professional development for each professional in the firm and maintain CPE reporting documents. Many firms develop in-house CPE programs and document those programs in accordance with AICPA and state rules and GAO standards. Most of the time and cost consequences are due to following the CPE program and documentation requirements of the AICPA, state boards of accountancy, and the GAO.

- *Standardized Checklists and Forms Can Facilitate CPE Compliance.* To minimize the administrative and documentation burden of complying with CPE related requirements, firms may consider adopting standardized CPE checklists, attendance records, etc., as part of the professional development QC system.

Professional Development Policies and Procedures May Cover All Professionals. As mentioned before, the QC standards only apply to the firm's accounting and auditing practice. However, it is a best practice for a firm's professional development policy and procedures to cover all professionals, including tax and consulting professionals. However, defining who is and who is not a professional, is sometimes problematic, especially for smaller firms that use paraprofessionals extensively. The AICPA CPE requirement applies only to AICPA members. The AICPA *Statement on Standards for Continuing Professional Education Programs* applies to CPAs, which it describes as individuals who are licensed and/or regulated by boards of accountancy.

<u>Seasonal Employees.</u> This course defines seasonal employees as those who work part-time or who work full-time, but do not work year-round (for example, someone hired to work only during the firm's busy season). The QC standards explain that policies and procedures over CPE and other professional development activities need to enable firm personnel to fulfill the responsibilities assigned to them. Thus, the ultimate decision as to the amount and type of CPE that seasonal employees need to obtain is up to the firm. Seasonal employees can ordinarily maintain the necessary knowledge through adequate on-the-job training and by obtaining CPE in areas directly relating to their duties. However, part-time seasonal professionals are still required to meet the CPE requirements of their state board of accountancy in order to maintain their CPA license.

<u>Paraprofessionals.</u> Many firms have paraprofessionals whose duties might be perceived as more than just providing administrative support, but firms rarely, if ever, warrant incurring the cost of paraprofessionals obtaining a required number of CPE hours. For example, many firms assign the responsibility for preparing recurring monthly journal entries for their write-up clients to paraprofessionals. As noted above regarding seasonal employees, the ultimate decision as to the amount and type of CPE that paraprofessionals need to obtain (if any) is up to the firm and is often based upon the responsibilities assigned to such paraprofessionals. Paraprofessionals can ordinarily satisfy the responsibilities of their duties through adequate on-the-job training and by obtaining limited amounts of CPE in areas that relate directly to their duties.

Initial Considerations Relating to Developing Policies and Procedures for Performance Evaluation, Compensation, and Advancement

Some practitioners may not intuitively see why performance evaluation, compensation, and advancement are addressed as part of a QC system. Those three activities affect a professional individual's motivation and commitment, and a lack of related policies and procedures will often negatively affect firm morale. Regardless of how adequately the other QC activities are addressed, if staff morale is low, there remains a high probability that the quality of some firm services will also be low. When viewed from the perspective of staff morale, performance evaluation, compensation, and advancement take a prominent position in a firm's QC system.

Performance evaluation, compensation, and advancement is concerned with establishing staff classification levels and job descriptions, evaluating the performance of the professional staff, and making objective determinations about compensation and promoting (or not promoting) individuals. In designing a QC system that addresses those concerns, the following subtle issues can be considered:

- *The Staff May Examine the Policy Very Closely.* The firm's policies and procedures on performance evaluation, compensation, and advancement will receive closer scrutiny by the firm's staff than any other QC policy. Professional staff will view this policy as an indication of what they can expect regarding pay increases, promotions, and a general idea of the time commitment necessary to become a partner in the firm. Accordingly, firms should use great care and tact when drafting those policies and procedures. For example, a general statement that staff accountants are ready to become senior accountants after two years could be taken literally by a staff member, regardless of whether that person has the knowledge and experience for the promotion. On the other hand, a vague policy that implies there are no objective measures for determining advancement may negatively impact an employee's motivation.

- *Caution Against Placing Too Much Emphasis on Commercial Considerations.* Many firms and partners may be too focused on bringing new business into the firm. While it is important and vital to the continuing success of the firm that new clients and engagements are acquired, growth of the firm should not be emphasized above the firm's commitment to quality and compliance with professional standards and regulatory and legal requirements, along with its available resources and capability to perform its engagements. Accordingly, caution is needed when developing the policies and procedures relating to performance evaluation, compensation, and advancement (especially as it relates to developing the job descriptions of partners and managers).

- *Consider Long-range Planning in the Design of the Policy.* Developing and implementing a performance evaluation, compensation, and advancement QC system (similar to the recruitment and hiring system) may necessitate the firm to consider difficult, long-range planning questions such as the following:

  - What are the partners' plans for retirement? (When and how?)

  - Are there plans to add another partner to the firm?

  - If a replacement partner will not be recruited from outside the firm, the firm needs to design an on-the-job partner training system for its staff and how will it accomplish this?

  - If the firm does anticipate adding another partner, what qualifications, compensation, and timetable should be considered?

  - Does the firm want to grow?

  - Does the firm want to avoid the challenges of growth by staying the same size?

At Some Stage in a Firm's Growth, a Personnel Manual May Be Developed. Many of the detailed policies and procedures in a QC system could alternatively be addressed in a personnel manual. Firms that have personnel manuals can reduce the length and complexity of their QC procedures (especially the writing of job descriptions) by referring to those procedures located in their personnel manual. Firms that do not presently have a personnel manual may want to consider investing the additional time to develop such a manual while they are designing their

QC system. On the other hand, procedures and job descriptions that would be documented in a personnel manual can be included in the body of a firm's QC document. (Many smaller firms prefer this method.) If the firm uses a personnel manual, it is important that personnel policies and procedures in the QC document agree with those in the personnel manual.

EVALUATING THE QC SYSTEM'S DESIGN

This course's ideas, recommendations, and suggestions relating to human resources can allow the firm to design a practical quality control system that meets its needs. The ultimate responsibility for the effectiveness of the quality control system rests with the firm. Checklists, such as those provided in *PPC's Guide to Quality Control*, can be helpful when designing the QC system and policies and procedures for human resources.

Additionally, firms can also consider examples of human resources matters noted in peer reviews. Exhibit 2-9 provides such information.

Exhibit 2-9

Human Resources Matters Noted in Peer Reviews

Recruitment and Hiring

- Hiring decisions are not adequately documented.
- Newly hired staff members are not informed of firm policies and procedures.
- Too minimal reference checking is performed.
- Hiring done in a *crisis* basis (i.e., hiring decisions not adequately planned).
- Firm hired individuals who did not actually meet the firm's stated qualifications for hire.

Determining Capabilities and Competencies/Assignment of Engagement Teams

- Excessive staff or partner workloads.
- Supervisory level staff members are assigned to specialized industry or complex engagements for which they have insufficient knowledge, experience, and training.
- Responsibility for making staff assignments on a day-to-day basis is not assigned, or is assigned to a person without adequate experience or support.
- Firm has inadequate QC procedures to identify staffing requirements for complex or specialized industry engagements.
- Assignments are not communicated to staff on a timely basis.
- Inadequate supervision of untrained staff.

Professional Development

- Failure to design QC policies that ensure partners and staff obtain appropriate CPE that meet state board requirements, AICPA membership requirements, etc.
- Failure to design QC policies that require relevant CPE for all levels of service and industries of engagements performed.
- CPE program needs to be expanded into more audit areas (e.g., planning, risk and materiality, supervision, sampling, and analytical review).

- CPE records and course materials are not adequately maintained nor periodically reviewed to ensure the completeness of compliance documentation required by state boards of accountancy or the AICPA.
- Failure to inform professionals of changes in professional literature.
- Failure of all applicable individuals, including partners, to meet *Government Auditing Standards* CPE requirements.
- Failure to maintain current licenses within all jurisdictions in which the firm practices.

Performance Evaluation, Compensation, and Advancement

- Promotion and reward are not adequately affected by quality performance, or too much emphasis is placed on practice development.
- Interim and/or annual evaluations are not performed on a timely basis.
- Promotion and reward are not based on documented performance evaluations.
- Criteria for evaluating individual performance and expected proficiency (what it takes to be promoted to the next level) are not adequately communicated to the staff.

* * *

MONITORING COMPLIANCE WITH HUMAN RESOURCES POLICIES AND PROCEDURES

The firm should review, on an ongoing basis, its human resources policies and procedures to determine if they continue to be appropriate for the firm. This review and assessment is normally accomplished in coordination with the monitoring phase of the firm's quality control system. Based on this review and assessment, the firm's policies and procedures should be revised as appropriate.

SELF-STUDY QUIZ

Determine the best answer for each question below. Then check your answers against the correct answers in the following section.

18. What type of CPE would be the most helpful to practitioners who have limited time available?

    a. College courses.

    b. Group live programs.

    c. Nano-learning programs.

    d. Speaking at a conference.

19. Planning for the firm's professional development program will cause which of the following?

    a. Rising CPE costs.

    b. A focus on group training.

    c. The elimination of specialists.

    d. Higher quality professional services.

20. What is one thing a CPA must do to earn CPE credit through independent study?

    a. Enter into a contract with the CPE sponsor.

    b. Choose the number of CPE credits the study will earn.

    c. Complete the program in a maximum of 30 weeks.

    d. Provide documentation to the CPE sponsor.

21. A certificate from the sponsor is appropriate documentation of what type of CPE activity?

    a. Group learning.

    b. College courses.

    c. Instruction credit.

    d. Publications.

22. The CPA firm of Malon & Brown is developing a circulation system for its professional library. Which of the following tasks should the firm perform to meet this goal?

    a. Encourage the firm as a whole to update the library as standards change.

    b. Circulate the *Journal of Accountancy* to all partners.

    c. File or archive the information after it has been distributed.

    d. Ensure that all staff members read every important publication.

23. Which of the following is typically provided at the beginning of employment and explains how employees should conduct themselves at work and how problems should be addressed?

    a. Orientation and training programs.

    b. Employee handbooks.

    c. Written job descriptions.

    d. Supervisory counseling.

24. Which of the following pieces of guidance should a firm apply toward designing and drafting its QC policies and procedures related to professional development?

    a. Professional development policies should be structured around CPE.

    b. The QC system requirements for CPE should be based on SQCS No. 8.

    c. Reserve a minimal amount of time to develop and maintain the professional development system.

    d. The use of standardized checklists can improve the firm's compliance in this area.

SELF-STUDY ANSWERS

This section provides the correct answers to the self-study quiz. If you answered a question incorrectly, reread the appropriate material. **(References are in parentheses.)**

18. What type of CPE would be the most helpful to practitioners who have limited time available? **(Page 191)**

    a. College courses. [This answer is incorrect. Graduate level college courses offer structured, detailed training in a particular subject, such as taxation, and can allow participants to earn graduate degrees. However, such courses generally take place over a semester, so the time required to take them is not flexible.]

    b. Group live programs. [This answer is incorrect. Attending group live programs, such as conferences and seminars, is one of the most popular forms of CPE. It can be an excellent way to learn about selected topics from real-time instructors or subject matter experts (SMEs) in a group setting. They also allow interaction with other professionals who may have practical insights into problems and solutions that cannot be found in textbooks. However, such programs must be attended at specific times and are not flexible. They also may not be particularly short. Therefore, they would not be specifically helpful in that regard.]

    c. Nano-learning programs. [This answer is correct. *Nano-learning* refers to information delivered in very small increments, such as 10-minute sessions, that often cover task-specific topics. Such programs are perfect for individuals in a time crunch. These programs deliver focused content on a clearly defined subject or concept, and participants must receive a 100% score on a qualified assessment to obtain CPE credit. Online tutorials and demonstrations are some common forms of nano-learning programs. Because nano-learning programs are shorter, they would be especially helpful for those with limited time available.]

    d. Speaking at a conference. [This answer is incorrect. Being the speaker, instructor, or discussion leader of a course or conference makes the individual essentially the teacher, and there is no better way to learn a subject than to teach it. Leading a CPE course can help individuals master subject areas and improve their communication skills. However, because courses and conferences are generally set to a particular, nonflexible timetable, they are not the right fit for someone with limited time available.]

19. Planning for the firm's professional development program will cause which of the following? **(Page 194)**

    a. Rising CPE costs. [This answer is incorrect. The CPE needs of the staff can be assessed and met more cost-effectively through planning. Therefore, planning will allow the firm to control such costs, not cause them to rise.]

    b. A focus on group training. [This answer is incorrect. Such planning will actually allow the firm to identify individual training needs. While group training is sometimes an option, staff who have specific training deficiencies need to be identified and training techniques designed to address those deficiencies.]

    c. The elimination of specialists. [This answer is incorrect. Such planning allows the firm to consider its needs for specialists and experts. Once identified, special courses or reference materials can be used and steps taken to fulfill those needs by creating specialists.]

    d. Higher quality professional services. [This answer is correct. Competent staff who stay abreast of the technical guidance necessary to perform their engagements are essential to a firm's ability to provide quality professional services. A properly planned professional development program helps the staff maintain such ability.]

20. What is one thing a CPA must do to earn CPE credit through independent study? **(Page 197)**

    a. Enter into a contract with the CPE sponsor. [This answer is correct. To earn CPE credit through independent study, the CPA must do five things, including enter into a written learning contract with the sponsor. The contract indicates the nature of the program and the time within which it is to be completed, as well as the maximum CPE credit that can be earned, agreed upon in advance.]

    b. Choose the number of CPE credits the study will earn. [This answer is incorrect. The CPA must accept the sponsor's written recommendation of the number of CPE credits that can be earned. Therefore, the sponsor gets to choose the number of credits, not the CPA.]

    c. Complete the program in a maximum of 30 weeks. [This answer is incorrect. The independent study program must be completed in 15 weeks or less.]

    d. Provide documentation to the CPE sponsor. [This answer is incorrect. The CPA, not the sponsor, must retain documentation as necessary to satisfy regulatory requirements as to the content, inputs, and outcomes of the independent study.]

21. A certificate from the sponsor is appropriate documentation of what type of CPE activity? **(Page 198)**

    a. Group learning. [This answer is correct. For group, blended learning, and independent study programs, a certificate or other verification supplied by the program sponsor is acceptable documentation, according to the CPE Standards.]

    b. College courses. [This answer is incorrect. For a university or college course that is successfully completed for credit, the CPE Standards require a record or transcript of the grade the person received. A certificate of attendance would be satisfactory for a noncredit course; however, since that is not the case for all college courses, there is a better answer to this question.]

    c. Instruction credit. [This answer is incorrect. For instruction credit, appropriate supporting documentation that complies with the requirements of the respective state boards subject to the guidelines of CPE Section 300.72 is acceptable documentation.]

    d. Publications. [This answer is incorrect. Per the CPE Standards, for published books, articles, or CPE programs, a copy of the publication that names the CPA as author or contributor, the writer's statement supporting the number of CPE hours claimed, and the name and contact information of the independent reviewer(s) or publisher is appropriate documentation.]

22. The CPA firm of Malon & Brown is developing a circulation system for its professional library. Which of the following tasks should the firm perform to meet this goal? **(Page 200)**

    a. Encourage the firm as a whole to update the library as standards change. [This answer is incorrect. It would be preferable for Malon & Brown to assign a specific person the responsibility for maintaining library updates.]

    b. Circulate the *Journal of Accountancy* to all partners. [This answer is incorrect. The *Journal* covers a variety of subjects including accounting, financial reporting, auditing, taxation, personal financial planning, technology, business valuation, professional development, ethics, liability issues, consulting, practice management, education, and domestic and international business issues. It would be a good idea for Malon & Brown to route this publication to all professionals, even those who are not partners.]

c. File or archive the information after it has been distributed. [This answer is correct. After the information has been distributed through the firm, it should be filed in the library or archived electronically. Malon & Brown should consider maintaining important news in a subject file once it has been circulated through the firm.]

d. Ensure that all staff members read every important publication. [This answer is incorrect. As Malon & Brown grows in size, it should delegate the responsibility for reading important publications to qualified professionals in the firm. Those individuals can clip, photocopy, or otherwise tag important articles for circulation.]

23. Which of the following is typically provided at the beginning of employment and explains how employees should conduct themselves at work and how problems should be addressed? **(Page 202)**

a. Orientation and training programs. [This answer is incorrect. Such programs generally convey the tasks employees are expected to perform and the performance standards the firm will apply. Such programs are oriented more toward job tasks and less toward personal conduct.]

b. Employee handbooks. [This answer is correct. An employee handbook can effectively communicate how employees are expected to conduct themselves while on the job and the consequences of noncompliance. Firms that use employee handbooks generally present that information to employees at the beginning of their employment because that document includes criteria that will impact the performance evaluation process.]

c. Written job descriptions. [This answer is incorrect. Job descriptions are particularly effective in expressing expectations about recurring job tasks. This focuses on ensuring employees understand the requirements of their positions, not the type of conduct issues described above.]

d. Supervisory counseling. [This answer is incorrect. Supervisory counseling on the job is a frank or prompt response that acknowledges weak or strong performance, and this is one effective method of conveying a firm's expectations. It can also be an invaluable method of correcting minor problems before they become major problems. However, such counseling is more of a case-by-case basis, and not something offered to all employees, as described above.]

24. Which of the following pieces of guidance should a firm apply toward designing and drafting its QC policies and procedures related to professional development? **(Page 213)**

a. Professional development policies should be structured around CPE. [This answer is incorrect. Too often professional development is thought of only in terms of CPE. However, the QC standards cover all activities that enable a firm to provide personnel with the knowledge and capability needed to fulfill their assigned responsibilities and to progress within the firm (e.g., on-the-job training).]

b. The QC system requirements for CPE should be based on SQCS No. 8. [This answer is incorrect. CPE rules of governing bodies such as the U.S. Government Accountability Office (GAO) and professional organizations such as the AICPA Governmental Audit Quality Center may have more stringent CPE requirements than those of QC 10. Accordingly, a firm's policies and procedures should also address professional development requirements of other governing bodies or professional organizations, if any.]

c. Reserve a minimal amount of time to develop and maintain the professional development system. [This answer is incorrect. It is difficult to avoid the reality that maintaining a professional development system can be time-consuming and costly. Most of the time and cost consequences are due to following the CPE program and documentation requirements of the AICPA, state boards of accountancy, and the GAO.]

d. The use of standardized checklists can improve the firm's compliance in this area. [This answer is correct. To minimize the administrative and documentation burden of complying with the CPE-related requirements, firms may consider adopting standardized CPE checklists, attendance records, etc., as part of their professional development QC system.]

EXAMINATION FOR CPE CREDIT

Companion to PPC's Guide to Quality Control—Course 2—Client Acceptance and Continuance and Human Resources (GQCTG182)

Testing Instructions

1. Following these instructions is an **EXAMINATION FOR CPE CREDIT** consisting of multiple choice questions. You may print and use the **EXAMINATION FOR CPE CREDIT ANSWER SHEET** to complete the examination. This course is designed so the participant reads the course materials, answers a series of self-study questions, and evaluates progress by comparing answers to both the correct and incorrect answers and the reasons for each. At the end of the course, the participant then answers the examination questions and records answers to the examination questions on either the printed **Examination for CPE Credit Answer Sheet** or by logging onto the Online Grading System. The **Examination for CPE Credit Answer Sheet** and **Self-study Course Evaluation Form** for each course are located at the end of all course materials.

   ONLINE GRADING. Log onto our Online Grading Center at **cl.tr.com/ogs** to receive instant CPE credit. Click the purchase link and a list of exams will appear. Search for an exam using wildcards. Payment for the exam of $95 is accepted over a secure site using your credit card. Once you purchase an exam, you may take the exam three times. On the third unsuccessful attempt, the system will request another payment. Once you successfully score 70% on an exam, you may print your completion certificate from the site. The site will retain your exam completion history. If you lose your certificate, you may return to the site and reprint your certificate.

   PRINT GRADING. If you prefer, you may email, mail, or fax your completed answer sheet, as described below ($95 for email or fax; $105 for regular mail). The answer sheets are found at the end of the course PDFs. Answer sheets may be printed from the PDFs; they can also be scanned for email grading, if desired. The answer sheets are identified with the course acronym. Please ensure you use the correct answer sheet. Indicate the best answer to the exam questions by completely filling in the circle for the correct answer. The bubbled answer should correspond with the correct answer letter at the top of the circle's column and with the question number. You may submit your answer sheet for grading three times. After the third unsuccessful attempt, another payment is required to continue.

   You may submit your completed **Examination for CPE Credit Answer Sheet, Self-study Course Evaluation,** and payment via one of the following methods:

   - Email to: *CPLGrading@thomsonreuters.com*
   - Fax to: **(888) 286-9070**
   - Mail to:

     Thomson Reuters
     Tax & Accounting—Checkpoint Learning
     GQCTG182 Self-study CPE
     36786 Treasury Center
     Chicago, IL 60694-6700

   Note: The answer sheet has four bubbles for each question. However, if there is an exam question with only two or three valid answer choices, "Do not select this answer choice" will appear next to the invalid answer choices on the examination.

2. If you change your answer, remove your previous mark completely. Any stray marks on the answer sheet may be misinterpreted.

3. Each answer sheet sent for print grading must be accompanied by the appropriate payment ($95 for answer sheets sent by email or fax; $105 for answer sheets sent by regular mail). Discounts apply for three or more courses submitted for grading at the same time by a single participant. If you complete three courses, the price for grading all three is $271 (a 5% discount on all three courses). If you complete four courses, the price for

grading all four is $342 (a 10% discount on all four courses). Finally, if you complete five courses, the price for grading all five is $404 (a 15% discount on all five courses). The 15% discount also applies if more than five courses are submitted at the same time by the same participant. The $10 charge for sending answer sheets in the regular mail is waived when a discount for multiple courses applies.

4. To receive CPE credit, completed answer sheets must be postmarked or entered into the Online Grading Center by **April 30, 2019**. CPE credit will be given for examination scores of 70% or higher.

5. When using our print grading services, only the **Examination for CPE Credit Answer Sheet** should be submitted. **DO NOT SEND YOUR SELF-STUDY COURSE MATERIALS.** Be sure to keep a completed copy for your records.

6. Please direct any questions or comments to our Customer Service department at (800) 431-9025.

EXAMINATION FOR CPE CREDIT

Companion to PPC's Guide to Quality Control—Course 2—Client Acceptance and Continuance and Human Resources (GQCTG182)

Determine the best answer for each question below. Then mark your answer choice on the Examination for CPE Credit Answer Sheet. The answer sheet can be printed out from the back of this PDF or accessed by logging onto the Online Grading System.

1. Assuming all other requirements from QC 10.27 are met, a firm must only accept or continue engagements if which of the following is true?

   a. It is assured that the client has complied with all ethical and legal requirements.

   b. The client believes that the firm has an appropriate amount of integrity.

   c. There is little to no risk involved in performing the engagement.

   d. It is both competent and capable to perform the engagement.

2. If there are no mitigating factors, what should a firm do if it finds out that its independence may be impaired with respect to a potential client?

   a. Decline the potential engagement.

   b. Accept the engagement, but spell out the conflict in the engagement letter.

   c. Accept the engagement, but withhold an opinion on areas related to the conflict.

   d. Take additional CPE before accepting the engagement.

3. The CPA firm of Hart & Gold takes on an examination engagement. Jake is the partner who closes the deal with the client. Rebecca is named the engagement partner. Rob and Allison will be part of the engagement team. Who is responsible for quality control on this engagement?

   a. Jake.

   b. Rebecca.

   c. Rob and Allison.

   d. The client.

4. Why would a firm perform a client screening?

   a. To discover evidence of a potential client's questionable behavior.

   b. To determine the length of the firm's relationship with the client.

   c. To determine the identity of those charged with the client's governance.

   d. To obtain management's agreement that the financial statements are prepared and presented in accordance with a specific framework.

5. A business that is a good corporate citizen and cares about doing the right thing will generally do what?

    a. Keep to itself rather than influence others.

    b. Change auditing firms frequently to ensure a lack of bias.

    c. Resolve all issues in the favor of its employees.

    d. Be actively involved in its community.

6. Which of the following preconditions must be met for a firm to accept an attestation engagement?

    a. The practitioner must take responsibility for the subject matter.

    b. The subject matter must be appropriate and have suitable criteria.

    c. The client must only restrict access to a minimum amount of information.

    d. The practitioner must agree to report the results of the engagement orally.

7. Policies and procedures for client acceptance and continuance should ensure that the firm gathers all the necessary information by what point?

    a. Before work on the engagement is completed.

    b. Before audit or other reports are issued.

    c. Before an existing client proposes a new engagement.

    d. Before a new client is accepted.

8. What is the most helpful method for evaluating an existing client's ongoing acceptability?

    a. A macro review of the client list once a year.

    b. A micro review of individual clients when planning the engagement.

    c. A combination of the macro and micro views.

    d. Allowing the existing client to do a self-review.

9. A cozy relationship with a long-standing client raises what type of risk?

    a. The risk of violating ethical requirements.

    b. The risk of consuming too many firm resources.

    c. The risk of performing with a marginal level of practice.

    d. The risk of providing services in high-risk industries.

10. Why might a firm perform a preliminary evaluation of a potential client's financial reporting system before accepting the engagement?

    a. To determine whether a scope limitation exists.

    b. To determine whether performing the engagement is feasible.

    c. To evaluate whether the potential client operates in a high-risk practice area.

    d. To assess whether the AICPA client evaluation tools will be needed.

11. What is the preferred method for obtaining an understanding with the client about the terms of the engagement?

    a. An oral agreement.

    b. Notes from a firm meeting.

    c. A firm memo.

    d. An engagement letter.

12. In addition to guidance on accepting and continuing client relationships, the firm's QC system should provide what other guidance related to this QC element?

    a. When to withdraw from the engagement.

    b. How to keep an engagement when professional standards require withdrawal.

    c. When profit is more important to a firm than integrity.

    d. How to withdraw from an engagement when doing so is prohibited by laws or other requirements.

13. Who is responsible for the decision to withdraw from an engagement?

    a. The client.

    b. The managing partner.

    c. The engagement partner.

    d. The firm's legal advisors.

14. Which of the following firms has correctly dealt with an issue related to withdrawing from an engagement?

    a. Audits 'R Us informs its client orally that it will be withdrawing from the engagement.

    b. Number Crunchers consults with its legal counsel before withdrawing from an engagement.

    c. Blankenship & Carson uses a form resignation letter for withdrawals that is the same for audits and SSARS engagements.

    d. Paul, Paul, & Meadows elects not to document withdrawals in case workpapers are subpoenaed in a breach of contract suit.

15. When is a firm required to withdraw from a SSARS engagement under AR-C 60?

    a. The client provides requested information after the deadline.

    b. The practitioner cannot obtain sufficient knowledge of the clients business.

    c. The client omitted disclosures with an intent to mislead in a compilation engagement.

    d. The practitioner's independence is impaired in a review engagement.

16. How should firms approach the policies and procedures provided in *Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice* (the AICPA Practice Aid)?

    a. These policies and procedures must be followed exactly or the firm must provide justification as to why.

    b. These policies and procedures can be used as a starting point, but firms must also consider their own needs.

    c. If the firm chooses to use these policies and procedures, all of the policies and procedures must be incorporated into the firm's QC system; the firm cannot pick and choose.

    d. These policies and procedures are merely illustrative of appropriate language and format; firms should write their own from scratch to meet their own specific needs.

17. Which of the following are (is) designed to achieve the objectives of the QC system as a whole?

    a. Specific objectives of individual QC elements.

    b. QC policies.

    c. QC procedures.

    d. Monitoring documentation.

18. Who is responsible for making sure a firm's QC system meets its needs?

    a. The firm.

    b. The AICPA.

    c. Peer reviewers.

    d. Accounting and auditing guides, such as those from PPC.

19. What is the smallest size firm for which having QC policies and procedures about recruitment and hiring is a best practice?

    a. Firms larger than sole practitioners.

    b. Firms with at least five partners and/or staff.

    c. Firms classified as small or medium sized.

    d. Large firms.

20. What is the best way for firms to describe the attributes sought in potential employees in its QC system?

    a. A comprehensive list of all must-have attributes.

    b. A general description that can be adapted during the process.

    c. A short list of qualities that cannot be overridden by partners.

    d. Attributes should not be covered in the QC system as QC systems should not be that specific.

21. Which of the following types of recruiting will most likely help a firm find qualified, entry-level employees?

Advertising in periodicals	Using websites
On-campus recruiting	Referrals from contacts or employees
Using employment agencies	Establishing an internship program

    a. Advertising in periodicals and on-campus recruiting.

    b. Using employment agencies and websites.

    c. On-campus recruiting, using websites, and establishing an internship program.

    d. Referrals from contacts or employees, establishing an internship program, advertising in periodicals, and using employment agencies.

22. Which of the following will allow a firm to give new employees detailed information about firm policies, such as overtime, vacation time, and advancement?

    a. A brochure provided at the interview.

    b. An oral discussion at the interview.

    c. An orientation or employee manual when they start.

    d. Allowing the new employee access to the firm's QC system.

23. Which of the following best describes *competencies* and *capabilities*?

    a. They are the knowledge, skills, and abilities that allow employees to perform engagements.

    b. The must be assessed using quantitative measurements rather than qualitative measurements.

    c. Being competent is having the ability to perform a specific task.

    d. Being capable is having the skills or expertise needed to perform a task.

24. According to QC 10.A27, which of the following is a required competency for engagement partners?

    a. Being able to delegate engagement tasks to staff members who are proficient in relevant technical aspects.

    b. Understanding the role of the firm's QC system and the AICPA's *Code of Professional Conduct.*

    c. Having positive personal attributes, such as professionalism and project management skills.

    d. Having leadership qualities, such as strategic thinking, negotiating, teamwork, and coaching.

25. A firm's compliance with QC 10 should do which of the following?

    a. Allow the firm to release auditor's reports that do not support the opinion expressed therein.

    b. Require engagement partners to gain competencies by performing accounting and auditing engagements.

    c. Ensure that firms apply the same requirements to engagement partners in different industries.

    d. Allow the firm to also comply with the Uniform Accountancy Act (UAA).

26. What guidance does *Government Auditing Standards* (the Yellow Book) give about assigning staff to governmental audit engagements?

    a. They should have the technical knowledge, skills, and experience needed for competency before beginning work.

    b. It defines a practitioner's specialist as an individual or organization possessing expertise in a field other than accounting or attestation and whose work in the field is used to help obtain evidence for the engagement.

    c. It explains that an external specialist is considered a member of the engagement team even when his or her participation is limited to consultation.

    d. It indicates that assigning more experienced staff is a way to address risks of material misstatement at the financial statement level.

27. What does a firm need to do before it formulates its staffing plan?

    a. Update its recruitment plan.

    b. Evaluate its staffing requirements.

    c. Communicate staff assignments.

    d. Create professional development plans.

28. Having enough time to perform the work for an engagement is considered being what?

    a. Competent.

    b. Capable.

    c. Available.

    d. Independent.

29. Which of the following pieces of guidance should be considered when the firm assigns staff to engagements?

    a. Continuing professional education (CPE) is the preferred method to gain needed competencies over engaging a qualified third party.

    b. Typically, only one partner is responsible for approving the firm's staffing plan.

    c. Engagement partners should be assigned to as many engagements as possible to ensure continuity in services.

    d. As the experience levels and abilities of staff members increase, the need for direct supervision decreases.

30. According to the AICPA bylaws, how much CPE must a member take during each three-year reporting period?

    a. 24 hours.

    b. 40 hours.

    c. 80 hours.

    d. 120 hours.

31. Jessica needs CPE about governmental audits, compilation engagements, and nonprofit financial statements to brush up on skills for future engagements. She also would like CPE that she can take at her convenience. What type of CPE would most likely be the best choice for Jessica?

    a. A blended learning program.

    b. An in-house seminar.

    c. Professional writing.

    d. Self-study programs.

32. What is the minimum amount of CPE an auditor must take in two years if he or she works on Yellow Book audits?

    a. 24 hours directly related to governments.

    b. 56 hours that increase audit proficiency.

    c. 80 hours related to governments and audit proficiency.

    d. 120 hours related to governments and audit proficiency.

33. Professional development plans should be created for whom?

    a. All of the engagement partners in the firm.

    b. Any professional who performs accounting and auditing engagements.

    c. All of the professionals in the firm.

    d. All firm employees, including part-time professionals and paraprofessionals.

34. Who has the responsibility for keeping and maintaining a professional's CPE records?

    a. The firm.

    b. The CPA.

    c. The state board.

    d. The CPE provider.

35. If a firm sponsors a CPE program, all of the following information should be included on the certificate of completion **except**:

    a. The firm's name and contact information.

    b. The participant's name and amount of CPE credit.

    c. NASBA's contact information.

    d. The sponsor's identification number from the state board.

36. What is the primary objective of a performance evaluation system?

    a. To provide employees with timely, objective counseling.

    b. To minimize the number of employees promoted.

    c. To fulfill policies and procedures for the human resources QC element.

    d. To increase administrative responsibilities.

37. What is a benefit of performing partner evaluations?

    a. Boosting morale.

    b. Eliminating the need for peer review.

    c. Helping distribute profits equitably.

    d. Rewarding commercial considerations.

38. Which of the following statements best describes compensation, advancement, and termination procedures?

    a. If all quality control procedures related to advancement and termination decisions are met, it is a given that applicable laws will be met, as well.

    b. At least annually, firm partners should meet to discuss compensation, advancement, and terminations based on personnel and economic conditions.

    c. It is a best practice to communicate information about compensation and advancement criteria in a message separate from the firm's personnel manual.

    d. Documentation of personnel classifications and responsibilities can be time consuming, so this step should be eliminated from the QC system if possible.

39. How might the AICPA *Peer Review Program Manual* (PRPM) help a firm design its human resources QC policies and procedures?

    a. Providing illustrative QC policies and procedures the firm can adapt for its own use.

    b. Providing tips, warnings, and reminders that firms can use to implement their QC policies and procedures.

    c. Providing a personnel manual that the firm can use to simplify its QC system.

    d. Providing a questionnaire that can be used as a reference.

40. Which of the following firms is exhibiting a common problem related to human resources that has been noted in peer reviews?

    a. H&B Inc. holds an orientation session for all new employees to familiarize them with QC policies and procedures.

    b. United CPAs tasks Fred to making staffing assignments on his own, but Fred has never done so before.

    c. Leon & Schultz expands its CPE program so that multiple audit areas are covered.

    d. Blueville Auditors designs its promotion and reward system based on quality performance, not practice development.

GLOSSARY

Acceptance and continuance: A firm's determination of whether or not to take on a new client or engagement or continue to perform in an existing client relationship. Part of acceptance and continuance is determining whether clients (or potential clients) run their businesses well and with integrity.

AICPA *Peer Review Program Manual* (PRPM): This guidance is effective for peer reviews commencing on or after January 1, 2017, and it provides a questionnaire that the peer reviewer should complete during the planning phase of the review to evaluate the design of the firm's quality control policies and procedures.

AICPA Practice Aid: *Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting And Auditing Practice,* issued by the AICPA in Fall 2016. It includes easier customization of illustrative policies and procedures and tools for better implementation of policies and procedures.

Competencies and capabilities: The knowledge, skills, and abilities qualifying personnel to perform engagements. Being *capable* is having the ability to perform the specific task. Being *competent* is having the requisite skill or expertise to perform the task.

Employee handbooks: These are used by firms to communicate how employees are expected to conduct themselves while on the job and the consequences of noncompliance.

Engagement partner: The *partner* or other designated individual in the firm who has the responsibility for the engagement and its performance and for the reports issued on behalf of the firm and who, when required, has the appropriate authority from a professional, legal, or regulatory body.

Human resources: A firm's methods for utilizing and managing its personnel to perform their assigned responsibilities. Also known as *personnel management.*

Monitoring: Reviewing *QC policies* and *procedures* on an ongoing basis to determine if they continue to be appropriate for the firm.

Nano-learning: Information delivered in very small increments, such as 10-minute sessions, that often cover task-specific topics.

Orientation and training programs: Programs that convey tasks employees are expected to perform and the performance standards that will be applied by the firm.

Paraprofessionals: Individuals who possess basic bookkeeping and accounting skills but lack the education or experience to be a member of the professional staff.

Partner: Any individual possessing the authority to bind the firm with respect to the performance of special services engagements, and any employee who possesses this authority without assuming the additional risks and benefits of ownership.

Performance evaluation system: This type of system is used to give employees objective counseling (i.e., feedback) on a timely basis.

Personnel: Professional-level individuals, such as *partners* and *staff.* This would include CPAs (and those qualified to seek that status), part-time professional employees who work year-round on accounting and auditing engagements, seasonal professional employees who work for the firm on accounting and auditing engagements during peak workload periods, contract professionals who may work on special nonrecurring projects for the firm or may be contracted to assist on accounting and auditing engagements during peak workload periods, and professional employees that work on specific areas of the engagement (e.g., IT or valuation specialists).

Practitioner's specialist: An individual or organization possessing expertise in a field other than accounting or attestation, and whose work in the field is used to assist in obtaining evidence for the service being provided. They can be internal to the firm (*practitioner's internal specialist*) or external to the firm (*practitioner's external specialist*).

Professional competence: The ability to make sound decisions in the performance of an engagement, including technical proficiency.

Quality control (QC) policies: These are designed to achieve the overall objectives of the firm's QC system and the specific objectives of the individual QC elements.

Quality control (QC) procedures: These are designed to provide the actions necessary to implement and monitor compliance with stated *QC policies.*

Seasonal employees: Employees who work part-time or who work full-time but do not work year-round (e.g., only during the firm's busy season).

Staff: All firm professionals and specialists, excluding *partners.*

Suitably qualified external person: Any individual outside of the firm possessing the competence and the capabilities to act as an *engagement partner* (e.g., a partner of another firm).

Supervisory counseling: This gives employees a frank and prompt response that acknowledges weak or strong performance, and it is an effective method of conveying the firm's expectations. It can also be an invaluable method of correcting minor problems before they become major problems.

Withdrawal: Leaving the client relationship or the engagement after work has already begun. This may occur when the firm obtains information that would have caused it to decline the engagement if the firm had discovered that information before accepting the client or engagement.

Written job descriptions: These are used by firms to express expectations about recurring job tasks.

INDEX

This index is a list of general topics discussed in this course. More specific key word searches can be performed using the search feature of this PDF.

A

AICPA PRACTICE AID
- Acceptance and continuance . . . 152
- Human resources . . . 206

ASSIGNMENT OF ENGAGEMENT TEAMS
- Communicating staff assignments . . . 183
- Evaluating client staffing and formulating a plan . . . 179
  - •• Approving the staffing plan . . . 183
  - •• Assigning engagement partners . . . 180
  - •• Assigning engagement teams . . . 180
  - •• Documenting the staffing plan . . . 182
  - •• Formal time budgets . . . 181
  - •• Formulate a staffing plan . . . 182
  - •• Modify staffing assignments based on competencies . . . 181
- Modifying the staffing plan for unforeseen events . . . 183
- QC 10 requirements . . . 177
- Special considerations
  - •• Attestation requirements . . . 178
  - •• AU-C 220 requirements . . . 178
  - •• Ethical requirements . . . 179
  - •• *Government Auditing Standards* . . . 179
  - •• Other audit requirements . . . 178
  - •• SSARS requirements . . . 179

ATTESTATION ENGAGEMENTS
- Determining competencies and capabilities . . . 175
- Gathering evidence of integrity . . . 128
- Practice area risk . . . 138
- Withdrawal considerations . . . 151

AUDIT ENGAGEMENTS
- Acceptance and continuance . . . 125
- Assignment of engagement teams . . . 178
- Practice area risk . . . 138
- Predecessor communications . . . 132
- Scope limitations . . . 132
- Withdrawal considerations . . . 149

C

COMPLIANCE WITH LEGAL AND RELEVANT ETHICAL REQUIREMENTS
- Conflicts of interest . . . 125
- Legal and regulatory requirements . . . 124
- Relevant ethical requirements . . . 124
- Special considerations—audit engagements . . . 125

D

DETERMINING COMPETENCIES AND CAPABILITIES
- Competencies of the engagement partner
  - •• Interrelationship of competencies and other QC elements . . . 177
  - •• Relationship of the HR element with the UAA . . . 177
- QC 10 requirements . . . 172
  - •• Continuing professional development . . . 174
  - •• Developing competence . . . 173
  - •• Examples of *competent* and *capable* . . . 173
  - •• Independence education . . . 174
  - •• Mentoring relationships . . . 174
  - •• Passing the CPA exam . . . 173
  - •• Professional education . . . 173
  - •• Work experience . . . 174
- Special considerations
  - •• *Government Auditing Standards* . . . 174
- SSARS requirements . . . 175

DOCUMENTATION
- Client and engagement acceptance/continuance . . . 136
- Compensation and advancement decisions . . . 206
- CPE records . . . 198
- Engagement withdrawal . . . 148
- New employee attributes . . . 169
- Personnel classifications and responsibilities . . . 205
- Professional development . . . 196
- Recruitment and hiring plan . . . 168
- Recruitment plan . . . 171
- Staffing plan . . . 182

DRAFTING THE FIRM'S QC POLICIES AND PROCEDURES
- Acceptance and continuance . . . 152
- Human resources, overall . . . 212
- Performance evaluation, compensation, and advancement . . . 214
- Professional development . . . 212
- Recruitment and hiring . . . 212
- The firm's quality control procedures . . . 157
  - •• Accepting a new client—adopt a standardized checklist . . . 158

E

EVALUATING FIRM COMPETENCE AND CAPABILITIES
- Industry or subject matter knowledge . . . 122
  - •• Ethics requirements when using third-party service providers . . . 123
- Meeting reporting deadlines . . . 124
- Regulatory or reporting requirements . . . 123

EVALUATING THE INTEGRITY OF THE CLIENT
- Factors to consider . . . 126
  - •• Attitude toward aggressive accounting and internal control matters . . . 127
  - •• Inappropriate client limitation regarding the scope of work . . . 127
  - •• Integrity and business reputation of the client . . . 126
  - •• Length of the relationship with the client . . . 128
  - •• Nature of operations and specific business practices . . . 127
  - •• Reasons for nonreappointment of the previous firm . . . 127
- Gathering evidence of integrity . . . 128
  - •• Dealings with employees . . . 131
  - •• Fiscal responsibility . . . 130
  - •• Formal company communications . . . 131
  - •• Interaction with CPAs and other professionals . . . 128
  - •• Openness of the client . . . 131
  - •• Profile as a corporate citizen . . . 129
  - •• Reputation in the community . . . 129
- Special considerations—attestation engagements . . . 132
- Special considerations—audit engagements
  - •• Predecessor communications . . . 132
- Special considerations—SSARS engagements . . . 133

EVALUATING THE OVERALL ADEQUACY OF THE QC SYSTEM'S DESIGN
- Acceptance and continuance . . . 158
- Human resources . . . 215

M

MATTERS NOTED IN PEER REVIEW
- Acceptance and continuance . . . 158
- Human resources . . . 215

MONITORING COMPLIANCE WITH THE FIRM'S QC POLICIES AND PROCEDURES
- Acceptance and continuance 158
- Human resources 215

O

OBTAIN CLIENT AGREEMENT ON ENGAGEMENT TERMS
- Engagement letters 147
- General 147

OTHER ACCEPTANCE AND CONTINUANCE CONSIDERATIONS
- Determining if scope limitations exist 140
- Evaluating engagement risk 140
- Evaluating industry risk 139
- Evaluating practice area risk 138
- Evaluating risk of violating ethical requirements 138
- Evaluating the financial reporting system and financial statements 140
- Significant issues discovered after the engagement begins 147
- Timing and scope of clients and engagements 134
  - Dismissing a current client 135
  - Documentation of client and engagement evaluation 136
  - Evaluating the acceptability of existing client relationships 134
  - Evaluating the client during the planning stage of each engagement 135
  - Evaluating the client list 134

P

***PEER REVIEW PROGRAM MANUAL* (AICPA)**
- Human resources 211

PERFORMANCE EVALUATION, COMPENSATION, AND ADVANCEMENT
- How quality and ethics affect compensation and advancement 204
- Making personnel aware of performance expectations 202
- Providing performance evaluation and counseling 202
  - Determining the frequency of evaluations 203
  - Evaluating administrative staff 203
  - Evaluating partner performance 203
  - Interim recognition of performance 203
  - Progress and career development 204
  - Selecting a staff evaluation form 202
- QC 10 requirements 201

PROFESSIONAL DEVELOPMENT
- AICPA Audit Quality Centers 194
  - Employee Benefit Plan Audit Quality Center 194
  - Governmental Audit Quality Center 194
- AICPA bylaw requirements 191
- CPE standards 191
  - Types of CPE programs 191
- Planning the firm's professional development activities 194
  - Changing professional standards 199
  - Create a professional development plan for each professional 195
  - Documentation 196
  - Maintain appropriate CPE records 198
  - On-the-job training 201
  - Select and develop professional development activities that meet CPE requirements 196
- Special considerations—*Government Auditing Standards* 193
- State boards of accountancy and state CPA societies 193

R

RECRUITMENT AND HIRING
- Determining attributes of new employees 169
  - Documenting the attributes sought 169
- Developing a recruitment plan 170
  - Consider a formal internship program 170
  - Documenting the recruiting plan 171
  - On-campus recruiting 170
  - Periodical advertising 170
  - Recruitment is a two-way process 171
  - Referrals 170
  - Screening potential candidates 171
  - Use of employment agencies and search firms 171
  - Use of websites 171
- Evaluating the candidates 171
- Explaining firm policies and procedures to job candidates and new employees 172
- Plan for the firm's personnel needs 167
  - Communicating the plan to those responsible 168
  - Documenting the recruitment and hiring plan 168, 171

S

SQCS NO. 8 (QC 10)
- Requirements
  - Acceptance and continuance 120
  - Human resources 163

SSARS ENGAGEMENTS
- Predecessor communications 133

W

WITHDRAWAL CONSIDERATIONS
- Withdrawing from an engagement or ending a client relationship 147
  - Attestation engagements 151
  - Audit engagements 149
  - Communicating the decision to withdraw or discontinue services 149
  - Compilation and review engagements 151
  - Determining when to withdraw from an existing engagement 148
  - Documenting a withdrawal 148
  - Responsibility for approving the decision to withdraw 148

EXAMINATION FOR CPE CREDIT ANSWER SHEET

Companion to PPC's Guide to Quality Control—Course 1—The Basics of Quality Control, the Peer Review Process, and Undergoing a System Review (GQCTG181)

Name: ______________________________

Firm Name: ______________________________

Firm Address: ______________________________

City: ______________________ State /ZIP: ______________

Firm Phone: ______________________ Firm Fax No.: ______________

Firm Email: ______________________________

Signature: ______________________________

Credit Card Number: ______________________ Expiration Date: ______________

Birth Month: ______________________ Licensing State: ______________

ANSWERS:

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You must complete the entire course to be eligible for credit.

	a	b	c	d		a	b	c	d		a	b	c	d		a	b	c	d
1.	○	○	○	○	11.	○	○	○	○	21.	○	○	○	○	31.	○	○	○	○
2.	○	○	○	○	12.	○	○	○	○	22.	○	○	○	○	32.	○	○	○	○
3.	○	○	○	○	13.	○	○	○	○	23.	○	○	○	○	33.	○	○	○	○
4.	○	○	○	○	14.	○	○	○	○	24.	○	○	○	○	34.	○	○	○	○
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10.	○	○	○	○	20.	○	○	○	○	30.	○	○	○	○	40.	○	○	○	○

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Course Acronym: GQCTG181

Your Name (optional): ______________________ Date: ______________________

Email: ______________________

Please indicate your answers by filling in the appropriate circle as shown:
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2. What did you find **least** helpful?
3. What other courses or subject areas would you like for us to offer?
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5. How many employees are in your company? ________
6. May we contact you for survey purposes (Y/N)? If yes, please fill out contact info at the top of the page. **Yes**/**No** ○ ○

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EXAMINATION FOR CPE CREDIT ANSWER SHEET

Companion to PPC's Guide to Quality Control—Course 2—Client Acceptance and Continuance and Human Resources (GQCTG182)

Name: ______________________________

Firm Name: ______________________________

Firm Address: ______________________________

City: ______________________ State /ZIP: ______________

Firm Phone: ______________________ Firm Fax No.: ______________

Firm Email: ______________________________

Signature: ______________________________

Credit Card Number: ______________________ Expiration Date: ______________

Birth Month: ______________________ Licensing State: ______________

ANSWERS:

This answer sheet and the following evaluation can be printed. If filling out a printed version, please indicate your answer for each question by filling in the appropriate circle as shown: Fill in like this ● not like this ⃠ ⊗ ✓.

You must complete the entire course to be eligible for credit.

	a	b	c	d		a	b	c	d		a	b	c	d		a	b	c	d
1.					11.					21.					31.				
2.					12.					22.					32.				
3.					13.					23.					33.				
4.					14.					24.					34.				
5.					15.					25.					35.				
6.					16.					26.					36.				
7.					17.					27.					37.				
8.					18.					28.					38.				
9.					19.					29.					39.				
10.					20.					30.					40.				

You may complete the exam online for $95 by logging onto our Online Grading Center at **cl.tr.com/ogs**. Alternatively, you may fax the completed Examination for CPE Credit Answer Sheet and Self-study Course Evaluation to Thomson Reuters (Tax & Accounting) Inc. at (888) 286-9070 or email it to *CPLGrading@thomsonreuters.com*. Mailing instructions are included in the Exam Instructions. Payment information must be included for all print grading. The price for emailed or faxed answer sheets is $95; the price for answer sheets sent by regular mail is $105.

Expiration Date: April 30, 2019

Self-study Course Evaluation

Please Print Legibly—Thank you for your feedback!

Course Title: Companion to PPC's Guide to Quality Control—Course 2—Client Acceptance and Continuance and Human Resources

Course Acronym: GQCTG182

Your Name (optional): ____________________ Date: ____________________

Email: ____________________

Please indicate your answers by filling in the appropriate circle as shown:
Fill in like this ● not like this ⃠ ⊗ ✓.

Satisfaction Level:	1	2	3	4	5	6	7	8	9	10
	Low (1) . . . to . . . High (10)									
1. Rate the appropriateness of the materials for your experience level:	○	○	○	○	○	○	○	○	○	○
2. How would you rate the examination related to the course material?	○	○	○	○	○	○	○	○	○	○
3. Does the examination consist of clear and unambiguous questions and statements?	○	○	○	○	○	○	○	○	○	○
4. Were the stated learning objectives met?	○	○	○	○	○	○	○	○	○	○
5. Were the course materials accurate and useful?	○	○	○	○	○	○	○	○	○	○
6. Were the course materials relevant and did they contribute to the achievement of the learning objectives?	○	○	○	○	○	○	○	○	○	○
7. Was the time allotted to the learning activity appropriate?	○	○	○	○	○	○	○	○	○	○

Please enter the number of hours it took to complete this course. ____________

Please provide any constructive criticism you may have about the course materials, such as particularly difficult parts, hard to understand areas, unclear instructions, appropriateness of subjects, educational value, and ways to make it more fun. Please be as specific as you can.
(Please print legibly):

Additional Comments:

1. What did you find **most** helpful?
2. What did you find **least** helpful?
3. What other courses or subject areas would you like for us to offer?
4. Do you work in a Corporate (C), Professional Accounting (PA), Legal (L), or Government (G) setting? ________
5. How many employees are in your company? ________
6. May we contact you for survey purposes (Y/N)? If yes, please fill out contact info at the top of the page. **Yes**/**No** ○ ○

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