Chapter Accy 9

APPENDIX A

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PERFORMING SYSTEM REVIEWS

Objectives

25. A system review is intended to provide the reviewer with a reasonable basis for expressing an opinion on whether, during the year under review—

a. The reviewed firm's system of quality control for its accounting and auditing practice has been designed in accordance with quality control standards established by the AICPA. See SQCS No. 2, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice (AICPA, Professional Standards*, vol. 2, QC sec. 20).

b. The reviewed firm's quality control policies and procedures were being complied with to provide the firm with reasonable assurance of conforming with professional standards.

26. Firms have system reviews because of the public interest in the quality of the engagements covered under a system review, and the importance to the accounting profession of maintaining the quality of those services.

Peer Review Risk

27. Just as the performance of an audit includes audit risk, the performance of a system review includes peer review risk. Peer review risk is the risk that the review team—

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

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

c. Reaches an inappropriate decision about the findings to be included in, or excluded from, the letter of comments, or about whether to issue a letter of comments.

28. Peer review risk consists of the following two parts:

a. The risk (consisting of *inherent risk* and *control risk*) that an engagement will fail to conform with professional standards, that the reviewed firm's system of quality control will not prevent such failure, or both.[1, 2]

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

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

b. The risk (*detection risk*) that the review team will fail to detect the design or compliance deficiencies in the reviewed firm's system of quality control that either result in the firm having less than reasonable assurance of conforming with professional standards or constitute conditions whereby there is more than a remote possibility that the firm will not conform with professional standards on accounting and auditing engagements.

29. Inherent risk and control risk relate to the reviewed firm's accounting and auditing practice and its system of quality control and should be assessed by the review team in planning the review. Based on that assessment, the review team determines the offices and engagements to be selected for review to reduce peer review risk to an acceptable low level. The lower the inherent and control risk, the higher the detection risk that can be tolerated and vice versa. The assessment of these risks is qualitative and not quantitative.

Basic Requirements

30. A system review should include the following procedures:

a. Plan the review, as follows.

1. Obtain a sufficient understanding of the nature and extent of the firm's accounting and auditing practice to plan the review. See paragraph 40.
2. Obtain a sufficient understanding of the design of the firm's system of quality control, including an understanding of the monitoring procedures performed since the prior review, to plan the review. See paragraph 41
3. Assess the peer review risk. See paragraphs 42 and .43
4. Use the knowledge obtained from the foregoing to select the offices and the engagements to be reviewed, and to determine the nature and extent of the tests to be applied in the functional areas. See paragraphs 44 and 49.

b. Perform the review, as follows.

1. Review compliance by the firm with its system of quality control. The review should cover all organizational or functional levels within the firm.
2. Review selected engagements, including the relevant working paper files and reports. See paragraphs 50 and 54.
3. Reassess the adequacy of the scope of the review based on the results obtained to determine whether additional procedures are necessary.
4. Have an exit conference with senior members of the reviewed firm and at least the team captain to discuss the review team's findings and recommendations and the type of report it will issue. See paragraph 55.
5. Prepare a written report on the results of the review and, if applicable, a letter of comments. See paragraphs 72 through 79.
6. Review and comment to the reviewed firm on the firm's response to the letter of comments, if any. See paragraph 80.

31. The AICPA Peer Review Board has authorized the issuance of programs and checklists, including engagement review checklists, to guide team captains and other members of the review team in carrying out their responsibilities under these standards. Failure to complete all relevant programs and checklists in a professional manner may create the presumption that the review has not been performed in conformity with these standards. Such a review cannot be accepted as meeting the requirements of the peer review program. System reviews are subject to oversight by the AICPA and the administering entity.

Scope of the Review

32. The review should cover a firm's accounting and auditing practice as defined in paragraph 4. It should be directed to the professional aspects of the firm's accounting and auditing practice; it should not include the business aspects of that practice. Moreover, review team members should not have contact with or access to any client of the reviewed firm in connection with the review.

33. The review should cover a current period of one year to be mutually agreed–upon by the reviewed firm and the review team captain. Ordinarily, the review should be conducted within three to five months following the end of the year to be reviewed. Client engagements subject to selection for review, ordinarily should be those with periods ending during the year under review. For attestation engagements, including a financial forecast or projection, the selection for review ordinarily should be those with report dates during the year under review. If the current year's engagement is not completed and a comparable engagement within the peer review year is not available, the prior year's engagement should be reviewed. If the subsequent year's engagement has been completed, the review team should consider, based on its assessment of peer review risk, whether the more recently completed engagement should be reviewed instead.

34. A firm is expected to maintain the same year–end on subsequent reviews. Nevertheless, circumstances may arise that require the firm to change its peer review year–end. In such situations, a firm may do so with the prior approval of the state CPA society administering its review.

35. The team captain should obtain the report on the last review of the firm and, if applicable, the letter of comments and the response thereto, and the letter accepting those documents. The team captain should consider whether the matters discussed in those documents require additional emphasis in the current review and, in the course of the review, should evaluate the actions of the firm in response to the prior report and letter of comments.

36. A divestiture of a portion of the practice of a reviewed firm during the year under review may have to be reported as a scope limitation if the review team is unable to assess compliance with the system of quality control for reports issued under the firm's name during that year. If the review team is able to review engagements of the divested portion of the reviewed firm's practice, then the review team should review such engagements considered necessary to obtain an appropriate scope for the peer review. In such circumstances, an appropriate scope is one in which the review covers all partners

and significant industry areas that existed before the divestiture. If the divested portion of the practice is unavailable for review and represents less than ten percent of the reviewed firm's accounting and auditing hours, then the review team does not have to modify the report for a scope limitation. In all other circumstances, the review team should carefully assess the effects the divestiture has on the scope of the peer review. A review team captain who is considering whether a peer review report should be modified for a scope limitation due to a divestiture should consult with the state CPA society administering the review.

37. A reviewed firm may have legitimate reasons for not permitting the working papers for certain engagements to be reviewed. For example, the financial statements of an engagement selected for review may be the subject of litigation or investigation by a government authority, or the firm may have been advised by a client that it will not permit the working papers for its engagement to be reviewed. In such circumstances, the review team should satisfy itself as to the reasonableness of the explanation. Also, in order to reach a conclusion that the excluded engagements do not have to be reported as a scope limitation, the review team needs to consider the number, size, and relative complexity of the excluded engagements, and should review other engagements in a similar area of practice as well as other work of the supervisory personnel who participated in the excluded engagements.

38. In reviewing a practice office, the accounting and auditing practice to be reviewed includes reports issued for or to another office of the reviewed firm, a correspondent firm, or an affiliated firm. For those situations in which engagements selected in the practice office being reviewed include use of the work of another office, correspondent, or affiliate, the review team may limit its review to portions of the engagements performed by the practice office being reviewed, but should evaluate the appropriateness of the instructions issued by the reviewed office and the adequacy of the procedures followed to conform with professional standards.

39. Reviewers should ask the state CPA society administering the review about any requirements of relevant state boards of accountancy that need to be met for the review to be accepted by such state board(s) as the equivalent of one performed under the state board's own positive enforcement program.

Understanding Accounting and Auditing Practice and System of Quality Control

40. The review team should obtain a sufficient understanding of the nature and extent of the reviewed firm's accounting and auditing practice to plan the review. This understanding should include knowledge about the reviewed firm's organization and philosophy, as well as the composition of its accounting and auditing practice. This knowledge is ordinarily obtained through such procedures as inquiries of appropriate management personnel and requests of management to provide certain background information, some of which will have been provided to the review team before the review was accepted.

41. SQCS No. 2 requires every CPA firm, regardless of its size, to have a system of quality control for its accounting and auditing practice. It states that the quality control policies and procedures applicable to a professional service provided by the firm should encompass the following elements: independence, integrity, and objectivity; personnel management; acceptance and continuance of clients and engagements; engagement performance; and monitoring. The review team should obtain a sufficient understanding of the reviewed firm's system of quality control with respect to each element to plan the review. The understanding should include knowledge about the design of the reviewed firm's quality control policies and procedures in accordance with quality control standards established by the AICPA. This knowledge is ordinarily obtained through such procedures as inquiries of appropriate management and supervisory personnel, as well as reviewing the firm's responses to a questionnaire developed by the AICPA Peer Review Board.

Assessing Peer Review Risk

42. In planning the review, the review team should use the understanding it has obtained of the reviewed firm's accounting and auditing practice and its system of quality control to assess the peer review risk associated with those areas. The higher the assessed levels of peer review risk, the greater the number of offices or engagements that need to be reviewed. The assessed level of peer review risk may be affected by circumstances arising within the firm (for example, individual partners have engagements in numerous specialized industries or the firm has a few engagements constituting a significant portion of the firm's accounting and auditing practice) or outside the firm (for example, new professional standards being applied for the first time or adverse economic developments in an industry).

43. When assessing risk, the review team should evaluate the reviewed firm's quality control policies and procedures over its accounting and auditing practice in relation to the requirements contained in SQCS No. 2. This evaluation provides a basis for the review team to determine whether the reviewed firm has adopted appropriately comprehensive and suitably designed policies and procedures that are relevant to the size and nature of its practice. When making the evaluation, the review team should discuss with the firm how it considered the guidance provided in the AICPA's *Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice.*

Extent of Compliance Tests

44. Based on its understanding of the reviewed firm's accounting and auditing practice and system of quality control, and its assessment of peer review risk, the review team should consider whether any modifications to the programs and checklists issued by the AICPA Peer Review Board are appropriate. The team captain should then develop a general plan for the conduct of the review, including the nature and extent of compliance tests. The compliance tests should be tailored to the practice of the reviewed firm and, taken as a whole, should be sufficiently comprehensive to provide a reasonable basis for concluding whether the reviewed firm's system of quality control was complied with to provide the firm with reasonable assurance of conforming with professional standards in the conduct of its accounting and auditing practice. Such tests should be performed at the practice office(s) visited and should relate either to broad functions or to individual engagements. The tests should include the following.

a. Review selected engagements, including working paper files and reports, to evaluate their conformity with professional standards and compliance with relevant firm quality control policies and procedures.

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

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

d. Review other evidential matter as appropriate. Examples include selected administrative or personnel files, correspondence files documenting consultations on technical or ethical questions, files evidencing compliance with professional development requirements, and the firm's library.

Selection of Offices

45. Visits to practice offices should be sufficient to provide the review team with a reasonable basis for its conclusions regarding whether the reviewed firm's quality control policies and procedures are adequately communicated throughout the firm and whether its system of quality control was complied with during the year under review based on a reasonable cross section of the reviewed firm's accounting and auditing practice, with greater emphasis on those offices with higher assessed levels of peer review risk. Examples of the factors to consider when assessing peer review risk at the office level include the following:

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

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

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

d. Recently merged or recently opened offices

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

For a multi office firm, the review should include a visit to the firm's executive office if one is designated as such.

Selection of Engagements

46. When combined with other procedures performed, the number and type of accounting and auditing engagements selected by the review team for review should be sufficient to provide the review team with a reasonable basis for its conclusions regarding the reviewed firm's system of quality control. The conclusions must address whether the system has been designed in accordance with the quality control standards for an accounting and auditing practice established by the AICPA and was being complied with during the year under review.

47. Engagements selected for review should provide a reasonable cross section of the reviewed firm's accounting and auditing practice, with greater emphasis on those engagements in the practice with higher assessed levels of peer review risk. Examples of the factors to consider when assessing peer review risk at the engagement level include size, industry area, level of service, personnel (including turnover, use of merged–in personnel, or personnel not routinely assigned to accounting and auditing engagements), litigation in industry area, and initial engagement.

48. The AICPA Peer Review Board may, from time to time, by Interpretations, require that specific types of engagements be selected for review.[3] Examples are engagements required by a regulatory agency to be reviewed or those in particular areas in which public interest exists. Therefore, after selecting the engagements to be reviewed, based on the risk assessment, the team captain should ensure that the scope of the review includes any such required engagements.

[3] Reviewers should be alert to Peer Review Standards Interpretations developed by the AICPA Peer Review Board that might affect the engagements selected for review.

49. The process of engagement selection, like office selection, is not subject to definitive criteria. Nevertheless, if the team captain finds that meeting all of the preceding criteria results in the selection of an inappropriate scope of the firm's accounting and auditing practice, the team captain may want to consult with the state CPA society administering the review about the selection of engagements for review. In such circumstances, the team captain should carefully consider whether—

a. Adequate consideration has been given to the *key audit area* approach to engagement review. (This is discussed more fully in the AICPA peer review programs and checklists.)

b. Too much weight has been given to the desirability of reviewing work performed by all or most supervisory personnel.

c. Adequate consideration has been given to engagement selection based on peer review risk on a firm–wide 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.

Extent of the Review of Engagements

50. The review of engagements should include the review of financial statements, accountants' reports, working paper files, and correspondence, as well as discussions with professional personnel of the reviewed firm. The review of audit engagements should ordinarily include all key areas of the engagements selected to determine whether well–planned, appropriately executed, and suitably documented procedures were performed in accordance with professional standards and the reviewed firm's quality control policies and procedures.

51. For each engagement reviewed, the review team should document whether anything came to its attention that caused it to believe the following.

a. The financial statements were not presented in all material respects in accordance with generally accepted accounting principles (GAAP) or, if applicable, an other comprehensive basis of accounting (OCBOA).

b. The firm did not have a reasonable basis under applicable professional standards for the report issued.

c. The documentation on the engagement did not support the report issued.

d. The firm did not comply with its quality control policies and procedures in all material respects.

52. If the review team answers *yes* with respect to any of the preceding items, the team captain should promptly inform an appropriate member of the reviewed firm (generally on a "Matter for Further Consideration" form). The reviewed firm should investigate the matter questioned by the review team and determine what action, if any, should be taken. If the reviewed firm concludes that its report on previously issued financial statements is inappropriate, as addressed in the section of SAS No. 1 entitled "Subsequent Discovery of Facts Existing at the Date of the Auditor's Report" (AICPA, *Professional Standards*, vol. 1, AU sec. 561), or the firm's work does not support the report issued, as addressed in SAS No. 46, *Consideration of Omitted Procedures After the Report Date* (AICPA, *Professional Standards*, vol. 1, AU sec. 390), the reviewed firm should take timely action, as appropriate, to correct such engagements. The reviewed firm should advise the team captain of the results of its investigation and document the actions taken or planned or its reasons for concluding that no action is required (generally on the "Matter for Further Consideration" form prepared by the reviewer).

53. If the reviewed firm believes that it can continue to support its previously issued report and the review team continues to believe that there may be a significant failure to reach appropriate conclusions in the application of professional standards, the review team should pursue any remaining questions with the reviewed firm and, if necessary, with the state CPA society administering the review. The review team should also consider whether it is necessary to expand the scope of the review by selecting additional engagements to determine the extent and cause of significant departures from professional standards.

54. In evaluating the reviewed firm's response, the review team should recognize that it has not audited the financial statements in question in accordance with generally accepted auditing standards (GAAS) and that it has not had the benefit of access to client records, discussions with the client, or specific knowledge of the client's business. Nevertheless, a disagreement on the resolution of the matter may persist in some circumstances and the reviewed firm should be aware that the state CPA society administering the review may refer unresolved matters to the AICPA Peer Review Board for a final determination.

Exit Conference

55. Prior to issuing its report and, if applicable, letter of comments, the review team should communicate its conclusions to senior members of the reviewed firm at an exit conference, which may also be attended by representatives of state CPA society administering entities, the AICPA Peer Review Board, or other authorized organizations with oversight responsibilities. The reviewed firm is entitled to be informed at the exit conference about any matters that may affect the peer review report and about the findings and recommendations that will be included in the letter of comments. Accordingly, except in rare circumstances that should be explained to the reviewed firm, the exit conference should be postponed if there is any

uncertainty about the report to be issued or the matters to be included in the letter of comments. The exit conference is also the appropriate vehicle for providing suggestions to the firm that do not have an effect on the report or letter of comments.

PERFORMING ENGAGEMENT REVIEWS

Objectives

56. The objectives of an engagement review are to provide the reviewer with a reasonable basis for expressing limited assurance that–

a. The financial statements or information and the related accountant's report on the accounting and review engagements and attestation engagements submitted for review, conform in all material respects with the requirements of professional standards; and

b. The reviewed firm's documentation conforms with the requirements of SSARS and the SSAEs applicable to those engagements in all material respects.

These objectives are different from the objectives of a system review in recognition of the fact that engagement reviews are available only to firms that perform no engagements under the SASs, or examinations of prospective financial statements under the SSAEs. Firms required to have an engagement review may elect to have a system review.

Basic Requirements

57. The criteria for selecting the peer review year–end and the period to be covered by an engagement review are the same as those for a system review (see paragraphs 33 and 34). The reviewed firm shall provide summarized information showing the number of its accounting and review engagements and attestation engagements, classified into major industry categories. That information should be provided for each partner of the firm who is responsible for the issuance of reports on such engagements. On the basis of that information, the reviewer or the state CPA society administering the review ordinarily should select the types of engagements to be submitted for review, in accordance with the following guidelines.

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

1. Review of historical financial statements
2. Compilation of historical financial statements, with disclosures
3. Compilation of historical financial statements that omits substantially all disclosures.
4. Attestation.

b. One engagement should be selected from each partner of the firm responsible for the issuance of reports listed in item *a* above.

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

The preceding criteria are not mutually exclusive; one of every type of engagement that a partner performs does not have to be reviewed as long as, for the firm taken as a whole, all types of engagements noted in item *a* above performed by the firm are covered.

58. For each engagement selected for review, the reviewed firm shall submit the appropriate financial statements or information and the accountant's report, masking client identity if it desires, along with specified background information, representations about each engagement and the firm's documentation required by SSARS and the SSAEs.

59. An engagement review consists of reading the financial statements or information submitted by the reviewed firm and the accountant's report thereon, together with certain background information and representations provided by the reviewed firm, and reviewing the documentation required by SSARS and the SSAEs submitted by the reviewed firm. In addition, an engagement review includes reviewing the firm's prior peer review report, and if applicable, letter of comment and letter of response.

60. An engagement review does not include a review of working papers prepared on the engagements submitted for review (other than the documentation referred to in paragraph 59), tests of the firm's administrative or personnel files, interviews of selected firm personnel, or other procedures performed in a system review. Accordingly, an engagement review does not provide the reviewer with a basis for expressing any form of assurance on the firm's system of quality control for its accounting practice. The reviewer's report does indicate, however, whether anything come to the reviewer's attention that caused him or her to believe that the reports submitted for review did not conform with the requirements of professional standards in all material respects or that the documentation on those engagements did not comply with the applicable requirements of SSARS and the SSAEs in all material respects.

61. A firm that has an engagement review should respond promptly to questions raised in the review, whether those questions are raised orally or in writing on a "Matter for Further Consideration" form. The reviewer will contact the firm, before issuing the peer review report, to resolve questions raised in the review.

62. The reviewer performing an engagement review should document the work performed using the programs and checklists issued by the AICPA Peer Review Board for that purpose. Failure to complete all relevant programs and checklists in a professional manner may create the presumption that the review has not been performed in conformity with these standards. Such a review cannot be accepted as meeting the requirements of the peer review program. Engagement reviews are subject to oversight by the AICPA and the administering entity.

63. Compliance with the positive enforcement program of a state board of accountancy does not constitute compliance with the AICPA practice–monitoring requirement for engagement reviews.

PERFORMING REPORT REVIEWS

Objectives

64. The objective of a report review is to enable the reviewed firm to improve the overall quality of its compilation engagements that omit substantially all disclosures. To accomplish this objective, the reviewer provides comments and recommendations based on whether the submitted financial statements and related accountant's reports appear to conform with the requirements of professional standards in all material respects. Firms required to have a report review may elect to have a system or engagement review.

Basic Requirements

65. The criteria for selecting the peer review year–end and the period to be covered by a report review are the same as those for a system review (see paragraphs 33 and 34) and an engagement review. The reviewed firm shall provide summarized information showing the number of compilation engagements under SSARS, where the firm has compiled financial statements that omit substantially all disclosures, classified into major industry categories. That information should be provided for each partner of the firm who is responsible for the issuance of reports on such engagements. On the basis of that information, the reviewer or the state CPA society administering the review ordinarily should select the types of engagements to be submitted for review, in accordance with the following guidelines:

a. One engagement should be selected from each partner of the firm responsible for the issuance of compiled financial statements that omit substantially all disclosures.

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

66. For each engagement selected for review, the reviewed firm shall submit the appropriate financial statements and the accountant's report, masking client identity if it desires, along with specified background information and representations about each engagement.

67. A report review consists of reading the financial statements submitted by the reviewed firm and the accountant's report thereon, together with certain background information and representations provided by the reviewed firm, including the firm's prior peer review report, and if applicable, letter of comment and letter of response.

68. A report review does not include a review of the working papers prepared on the engagements submitted for review, tests of the firm's administrative or personnel files, interviews of selected firm personnel, or other procedures performed in a system or engagement review. Accordingly, a report review does not provide the reviewer with a basis for expressing any form of assurance on the firm's system of quality control for its accounting practice.

69. A firm that has a report review should respond promptly to questions raised in the review, whether those questions are raised orally or in writing. The reviewer will contact the firm, before issuing the peer review report, to resolve questions raised in the review.

70. The reviewer performing report review should document the work performed using the programs and checklists issued by the AICPA Peer Review Board for that purpose. Failure to complete all relevant programs and checklists in a professional manner may create the presumption that the review has not been performed in conformity with these standards. Such a review cannot be accepted as meeting the requirements of the peer review program. Report reviews are subject to oversight by the AICPA and the administering entity.

71. Compliance with the positive enforcement program of a state board of accountancy does not constitute compliance with the AICPA practice–monitoring requirement for report reviews.