

## Enhanced Audit Quality Discussion Paper Launched

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Peer Review and practice monitoring systems have been in place for well over two decades, and they have increased the quality and compliance for most practice units with the goal to better serve the stakeholders and the public.

Initially, Peer Review was designed around a remedial program to educate and assist firms with quality and compliance issues. The Peer Review Program has provided access to needed resources and has focused on the proper use of practice aids along with monitoring educational, knowledge and skill level requirements needed to perform the more complex and high-risk engagements.

The majority of firms and individuals have been able to fully implement a quality control system that is suitably designed and complied with to provide reasonable assurance of performing and reporting in conformity with applicable professional standards. This has brought new focus on acquiring tools, education, skills and resources necessary to meet standards.

The peer review process has been moving towards a more punitive program for those finding themselves out of compliance. With advances in technology that enable easy access of public information, coupled with findings by regulation agency oversight, it has been discovered that some have not reported their engagements properly or failed to have a peer review altogether. Some firms who have undergone a peer review and received a pass rating subsequently had deficiencies identified by peer review and regulatory agency oversights. These deficiencies should have been identified by the peer reviewer. Still other firms have been performing high-risk and must select engagements incorrectly for several years prior to the scheduled peer review (every 3 years) and identifying the deficiencies was not done timely and did not allow for timely correction of the findings. The current system in place is not adequate to deliver the firm with needed corrective actions to bring engagements into compliance in year one.

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During the last decade, peer review has also become more complex with increased regulations and interventions by regulatory agencies. In a climate of complexity and transparency it is important that our Peer Review monitoring and quality control system testing are robust, timely performed, comprehensive, cover all issuers, and are performed by individuals possessing the required technical knowledge to ensure that our stakeholders are well protected.

To address these and other issues, in May of 2014 the AICPA launched its Enhancing Audit Quality Initiatives (EAQ), an overview of its more salient contents follows. We strongly recommend you read it in its entirety. The discussion paper outlines the AICPA’s near and longer-term plans and proposals to address quality issues and is well written and easy to follow. The discussion paper is open for comments until November 7, 2014. Once the comment period has passed you should look for specific proposals and exposure draft development.

The discussion paper is intended for all stakeholders in the audit process for private entities. This effort is designed to help auditors excel in their long standing commitment to provide high-quality services that protect the public. Private entity financial statement audits refer to all non-SEC entities including not-for-profit organizations, employee benefit plans, and governmental entities.

The EAQ project focuses on multiple areas including competency and due care, auditing and quality control standards, guidance, tools, learning and resources, practice monitoring (peer review), ethics enforcement, integrity and objectivity. The coverage of this project will be very comprehensive and needs to be understood by all.

The long term goal is to transform practice monitoring with a strong focus on quality issues that have emerged. This goal includes efforts regarding audit performance and collective improvement to quality of audit services delivered.

Phase 1 involves planned and proposed efforts to improve quality in the near terms and outlines expected changes in professional standards and related implementation guidance, tools, learning and resources, amendments to the existing peer review program and efforts in the ethics enforcement process.

Phase 2 deals with transforming the current peer review program into a more real-time process resulting in earlier detection and correction of firm and engagement quality issues.

Many enhancements will need to be made to the current peer review system to meet the near term and long term goals. These enhancements will take full advantage of recent technological innovations and will focus on continual improvements and a commitment to quality. The enhancements will provide a process that will provide firms with near real-time feedback to correct deficiencies and in some cases this will take place prior to the completion of the engagement.

Peer reviewers have an obligation to the profession to service the public's interest by performing high-quality peer reviews. The Peer Review Board is proposing that all reviewers of "must select" engagements subject to Employment Retirement Income Security Act or Government Auditing Standards be members of the respective AICPA Audit Quality Center, and attend annual



industry specific training. In addition the training would require the peer reviewer to pass a competency exam. The AICPA feels that this will better insure that the peer reviewers will possess the knowledge and skills required to properly perform the more complicated peer review assignments and have access to needed practice tools. The quality centers provide many resources to better aid the firm under review as well as the reviewer.

New initiatives will be designed to increase audit quality with a strong focus on high-risk audit areas and high-risk and emerging industries. The initiatives will further focus firms and peer reviewers on areas of independence, sufficiency of audit evidence, employee benefit plans, municipalities that issue securities, and other emerging risk areas.

While the formal program will not be finalized until the response to the discussion paper can be evaluated, the AICPA Peer Review Board has approved a partial implementation of the Emerging Industries and Risk Areas Initiative. Please visit the AICPA web site to review all of the details regarding the list below:

- Independence
- Sufficiency of Audit evidence
- Employee Benefit Plan Audits
- Municipalities

The Peer Review Board (PRB) wishes to reduce to zero firms that do not report their engagements properly or fail to enroll. The PRB will leverage sources of engagement and firm data including but not limited to information provided by, DOL, eFAST2, the Single Audit Clearing House, Dun and Bradstreet and NASBA Accounting Licensee Database. Upon findings of non-compliance, consequences will be imposed that will be sufficient to correct and eliminate non-compliance.

These actions will help guarantee that the CPA profession continues to be highly regarded for serving and protecting the public interest. Effective, well thought out self-regulation procedures and requirements will prove highly beneficial to all stakeholders and our membership. We need everyone to participate in this team effort to insure enhanced audit quality for our stakeholders. We are confident that we will meet this challenge and will continue to enjoy the many benefits of being a most trusted advisor.

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## Firm & Individual License Interpretation Revision

In order to address the public's expectations of the AICPA Peer Review Program (Program), improve the Program's credibility and affirm its commitment to quality, the Peer Review Board has approved revisions to guidance relating to firm and individual licensing, effective for reviews commencing on or after January 1, 2015. The guidance will also help firms adhere to SQCS 8 which requires compliance with "applicable legal and regulatory requirements", which includes firm and individual licensing requirements.

Interpretation 208-1a-1 "Firm and Individual Licenses" will be revised and will indicate that a reviewer is required to verify:

- The practice unit license (firm license) in the state in which the practice unit is domiciled (main office is located).
- Individual (personnel) licenses in the state in which the individual primarily practices public accounting
  - For System Reviews, for a sample of appropriate personnel
  - For Engagement Reviews, for appropriate personnel on engagements selected

The reviewer will also verify the license by requiring the firm to provide 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.

These steps are in addition to the existing requirements that reviewers should make inquiries of the firm to determine if the firm and its personnel are appropriately licensed, and the existing requirement that reviewed firm's submit written representations indicating compliance with such required rules and regulations. The reviewer must analyze the information obtained through these steps to determine the firm's compliance with firm and individual licensing requirements and then the impact on the peer review.

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

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

For System Reviews, the team captain will also obtain an understanding of the firm's system of quality control with respect to firm and individual licensing.

## Important Message to Firms Regarding Peer Review Compliance and Completeness

Over the past several months, a joint Department of Labor (DOL) and AICPA Peer Review Program (program) initiative identified numerous CPA firms associated with an ERISA plan audit omitted that practice area from their peer review, whether intentionally or unintentionally. In some of the cases, the exclusion of the engagements from the peer review was the failure of firm personnel to apply due professional care to ensure that the engagements were properly identified to the administering entity or the peer reviewer. In other cases, the firms did not understand the requirements and scope of the program.

Firms should understand the following to avoid the common errors:

- Limited scope benefit plan audits are considered audits performed under Statements on Auditing Standards (SAS) that should be included in the peer review scope.
- All engagements within the peer review scope should be properly identified based on level of service and industry. For example, if your firm performs the financial audit for an entity, and also performs other services for the same entity (such as the employee benefit plan audit or agreed upon procedures engagement), each of the engagements must be separately identified on the listing provided for the peer reviewer.
- All engagements that your firm performed or expects to perform during the period covered by the peer review should be included in the peer review scope. This includes engagements with periods ending during the peer review year that are not completed and issued until after the peer review year end.

These errors and omissions can and have led to consequences such as the recall of peer review reports and related acceptance and performance of replacement reviews.

The AICPA Peer Review Board (PRB) has taken steps to emphasize the importance for firms to provide complete and accurate information during the peer review process to mitigate errors and omissions. These steps include an explicit engagement completeness representation from firms, additional firm inquiries by the reviewer, and clarification that failure to provide an accurate representation of the firm's accounting and auditing practice is considered noncooperation with the program.

Noncooperation with the program may result in a hearing by the board to determine if the firm's enrollment in the program should be terminated. If a firm's enrollment is terminated related to errors or omissions, the responsible individual will also be referred to the AICPA Professional Ethics Division for investigation of a possible violation of the AICPA Code of Professional Conduct.

Firms subject to system reviews are required to discuss with the reviewer the process and related controls in place to determine completeness of the engagement listing population. In planning for the peer review, it is imperative that someone within the peer reviewed organization accountable for quality control of the firm take responsibility for the completeness and accuracy of the information provided to the administering entity and the peer reviewer. This responsibility includes accurate identification of individual engagements to allow the reviewer to make a proper selection.

The administering entity and AICPA staff may undertake additional measures to ensure the completeness of firms and engagements within the program. These steps may include comparison of information from publicly available sources. To avoid detrimental consequences, firms should take care to provide complete and accurate information for the peer review. If your firm has any question about which engagements should be included in the scope of a peer review, refer to the online Q&A About the AICPA Peer Review Program at:

[www.aicpa.org/InterestAreas/PeerReview/Resources/FAQs/DownloadableDocuments/qandaprp.pdf](http://www.aicpa.org/InterestAreas/PeerReview/Resources/FAQs/DownloadableDocuments/qandaprp.pdf). Your firm should also refer to the guidance provided by the program in PRP Section 4100, Instructions to Firms Having a System Review, located at:

[www.aicpa.org/InterestAreas/PeerReview/Resources/PeerReviewProgramManual/2014/DownloadableDocuments/4100-Inst-Firm-Sys-Rev.pdf](http://www.aicpa.org/InterestAreas/PeerReview/Resources/PeerReviewProgramManual/2014/DownloadableDocuments/4100-Inst-Firm-Sys-Rev.pdf) for the proper way to identify engagements by service level and industry.

In addition to the aforementioned resources, you may contact NEPR or the AICPA's Peer Review Hotline at [prptechnical@aicpa.org](mailto:prptechnical@aicpa.org) or 919.402.4502, option 3, with additional questions. If your firm believes that there was an omission or misrepresentation about the firm's accounting and auditing practice on its most recent peer review, you are encouraged to contact NEPR immediately.

## Interpretation 101-3, Nonattest Services: What You Should Know



This article focuses on the independence requirements of CPAs when providing nonattest services to clients under AICPA professional standards. Some regulatory bodies, such as the SEC, PCAOB and GAO, have established independence requirements that may be more restrictive with regard to the provision of nonattest services for an audit client.

### What Should You Know?

When providing attest services to clients, practitioners must be independent, in both mind and appearance, and comply with the requirements of Interpretation 101-3 when providing nonattest services to their attest clients. The provision of nonattest services to an attest client may result in self-review and management participation threats to independence. A self-review threat exists when a CPA reviews, as part of an attest engagement, evidence that results from his or her firm's own nonattest work. A management participation threat exists when a CPA assumes responsibilities that are the role of client management during the performance of the nonattest service which causes the CPA to function as management in connection with the service. In some cases, the threats created by certain nonattest services are so significant that the services would impair independence.

Interpretation 101-3 provides specific guidance to CPAs on the types of nonattest services that would and would not impair independence. For those nonattest services that are permitted, the guidance requires that specific safeguards (i.e., general requirements) be implemented by both the CPA and client management in order to reduce the self-review and management participation threats to an acceptable level. This allows a CPA to act with integrity and exercise objectivity and professional skepticism during the performance of the attest engagement. Less restrictive independence requirements exist when performing nonattest services for a client for which the CPA only performs engagements under the Statements on Standards

for Attestation Engagements (SSAEs). See Interpretation 101-11—Modified Application of Rule 101 for Engagements Performed in Accordance With Statements on Standards for Attestation Engagements [ET section 101.15].

Interpretation 101-3 provides examples of common nonattest services that CPAs provide to their clients. As part of the peer review, peer reviewers should be satisfied that the firm has identified all nonattest services provided to attest clients and determine that none of the services would expressly impair independence under Interpretation 101-3. For those nonattest services that would not impair independence, peer reviewers should also be satisfied that the firm has complied with all of the required safeguards set forth in Interpretation 101-3 as discussed below.

The first safeguard is a key underpinning of the rule: the CPA must not assume management responsibilities on behalf of the attest client. If a CPA were to assume management responsibilities while performing nonattest services, the management participation threat would be considered so significant that independence would be impaired. Various examples of management responsibilities are provided within Interpretation 101-3.

The remaining safeguards involve responsibilities that the client must agree to. The CPA should be satisfied that client management performs all of these functions in connection with the nonattest services (either through documentation or verbal discussions with the client):

- Assume all management responsibilities;
- Oversee the nonattest service, by designating an individual, preferably within senior management who possesses suitable skill, knowledge, and/or experience, or SKE;
- Evaluate the adequacy and results of the services performed; and
- Accept responsibility for the results of the services.

The individual designated by the client to fulfill these responsibilities will likely depend on the nature of the client's organization and the nature of the nonattest services engagement. In an owner-managed business, it may often be the owner, but depending on the nature of the nonattest services and the qualifications (i.e., skill, knowledge, and/or

experience, or SKE) of other client employees or individuals, it also could be the controller, bookkeeper or another employee. In larger organizations or for more complex services, the client is more likely to designate a senior officer to oversee the services. The employee or individual responsible for overseeing the nonattest services should be in a position to understand the services sufficiently to oversee them but does not need to possess the technical qualifications to perform or re-perform the services.

CPAs are expected to use their professional judgment and experience to determine whether the individual designated by the client can fulfill these responsibilities. In cases where the client is unable or unwilling to assume these responsibilities, the self-review and management participation threats would be so significant that independence would be impaired. For example, if the individual overseeing the nonattest service does not possess suitable skill, knowledge, and/or experience (SKE) to do so, there would be no one other than the CPA to make the significant judgments that become necessary during the performance of the nonattest services.

#### **Peer Review and Interpretation 101-3 Requirements**

The peer reviewer will use his or her professional judgment to determine if the practitioner satisfied these Interpretation 101-3 requirements. Compliance may be evidenced by documentation, or it may be supported by non-documented means, for instance, by assessing:

- the practitioner's and the firm's level of understanding of the guidance as communicated through discussions
- the firm's policies and procedures to communicate and educate its staff on the guidance
- whether the practitioner is familiar with the circumstances at the client and able to clearly explain the thought process and rationale regarding the conclusion reached and,
- whether the practitioner's conclusions were appropriate.

However, CPAs must establish and document, in writing, their understanding with client management regarding the following:

- Objectives of the engagement;
- Services to be performed;
- Client's acceptance of its responsibilities;
- CPA's responsibilities; and
- Any limitations of the engagement.

In fulfilling this requirement, CPAs may use their discretion in

determining the specific method of documentation. For example, if the CPA performs bookkeeping services for an audit client, the CPA may decide to document the required elements with respect to the bookkeeping services in the audit engagement letter. The understanding also could be documented, for example, in a separate engagement letter specific to the bookkeeping services engagement, a memo to the audit files or a checklist that the CPA completes as part of the audit. The peer reviewer should request to see such documentation as part of the firm's peer review.

#### **Peer Review Impact**

Supplemental Guidance (3100) section "Implications of Interpretation No. 101-3, Performance of Nonattest Services" provides guidance on how to address Interpretation 101-3 compliance issues in a peer review. It indicates that:

- When a firm performs an engagement when it lacks independence, the engagement would be deemed as not being performed or reported on in conformity with applicable professional standards (i.e. "nonconforming") (except on compilation engagements where the accountant's report has appropriately noted the lack of independence).
- However, if a firm fails to meet the documentation requirements of Interpretation 101-3's requirement to establish and document in writing (before performing nonattest services) his or her understanding with the client (objectives, services, client's acceptance of and the practitioner's responsibilities and limitations), that alone does not cause an impairment of independence and therefore does not automatically result in a nonconforming engagement.
- When a firm fails to meet other requirements of Interpretation 101-3 (relating to the practitioner being satisfied that management has agreed and can assume all management responsibilities, has an individual with SKE to oversee the service, can evaluate the adequacy and results of the services performed and accept responsibility for the service results), then independence has been impaired and the engagement would be deemed nonconforming.

#### **What Changes are Coming?**

While understanding current Interpretation 101-3 requirements, we recommend that you also become aware of enhancements which will be effective for engagements covering periods beginning on or after December 15, 2014:

- Preparing financial statements, reconciliations or cash to accrual conversions for an attest client

constitutes performing a nonattest service and the “general requirements” must be implemented in order to maintain independence.

- Performing multiple nonattest services can increase the significance of threats and so before agreeing to perform nonattest services, the member should evaluate whether the performance of multiple nonattest services in the aggregate creates a significant threat to the member’s independence that cannot be reduced to an acceptable level by the application of the safeguards contained in the general requirements of Interpretation 101-3. In situations where a member determines that threats are not at an acceptable level, safeguards in addition to the general requirements of Interpretation 101-3 should be applied to eliminate the threats or reduce them to an acceptable level. If no safeguards are available to eliminate or reduce the threats to an acceptable level, independence would be impaired.

In addition, the AICPA’s Professional Ethics Executive Committee (PEEC) adopted a revised AICPA Code of Professional Conduct (code) that will be effective December 15, 2014. In the revised code the numeric citations and titles of interpretations have all changed. For example, the guidance from Interpretation 101-3, *Nonattest Services* [ET section 101.05] is now found in various interpretations in the Nonattest Services subtopic [ET 1.295] such as:

- *Scope and Applicability of Nonattest Services* interpretation [ET 295.010]
- *Cumulative Effect on Independence When Providing Nonattest Services* interpretation [ET 1.295.020]
- *Management Responsibilities* interpretation [ET 1.295.030]
- *General Requirements for Performing Nonattest Services* interpretation [ET 1.295.040]
- *Documentation Requirements When Providing Nonattest Services* interpretation [ET 1.295.050]

The revised code will be housed in a new system with expanded features, which is expected to be live by the 3rd quarter of 2014. Until then, interested parties are encouraged to view the version of the [revised Code](#) that was submitted to the PEEC for approval at its January 28, 2014 meeting (subject to editorial review). To assist users in locating content from the prior code in the revised code, the PEEC created a mapping document. The mapping document is available in an Excel format at [mapping](#) and can also be found in appendix D in the revised code.

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AICPA “Interpretation 101-3, Nonattest Services: What a Peer Reviewer Should Know”, *Reviewer Focus*, April, 2014:  
<http://www.aicpa.org/InterestAreas/PeerReview/NewsAndPublications>

## Peer Reviews: System Review vs. Engagement Review

The AICPA has developed the chart below to help you understand what type of peer review your firm should undergo and the types of engagements your firm must specify for system reviews via questions 18 and 19 on the Information for Scheduling Reviews Form. Engagements covered in the scope of the Peer Review Program are those included in the firm’s accounting and auditing practice that are not subject to PCAOB permanent inspection. See Interpretation 6-9 of the Peer Review Standards, Engagements Subject to PCAOB Inspection, for more information.

There are two types of reviews:

- System Review – if your firm performs any of the services mentioned below as its highest level of service, your firm should have a System Review.
  - Engagements under the Statements on Auditing Standards (SASs) or *Government Auditing Standards (GAS)*,
  - Examinations under the Statements on Standards for Attestation Engagements (SSAEs), or
  - Audits of non-SEC issuers performed pursuant to the standards of the PCAOB.
- Engagement Review – If your firm performs either of the types of services listed below as its highest level of service, your firm should have an Engagement Review.
  - Services under Statements on Standards for Accounting and Review Services (SSARs) or
  - Services under the SSAEs not listed above in System Reviews

If you still have questions about the type of review your firm should undergo, please review the chart below:

If a Firm Performs These Types of Engagements as Its Highest Level of Service, the Firm Would be Required to Have:	System Review	Engagement Review
<b>Statements on Auditing Standards (SAS)</b>		
Audits	X	
<b>Government Auditing Standards (GAS)</b>		
Audits	X	
<b>Statements on Standards for Attestation Engagements (SSAEs)</b>		
Examinations performed under AT section 101, <i>Attest Engagements (AICPA, Professional Standards)</i>	X	
Reviews performed under AT section 101		X
Agreed-upon procedures performed under AT section 201, <i>Agreed-Upon Procedures Engagements (AICPA, Professional Standards)</i>		X
Examinations of prospective financial statements performed under AT section 301, <i>Financial Forecasts and Projections (AICPA, Professional Standards)</i>	X	
Compilations of prospective financial statements and application of agreed-upon procedures to prospective financial statements performed under AT section 301		X
Examinations performed under AT section 401, <i>Reporting on Pro Forma Financial Information (AICPA, Professional Standards)</i>	X	
Reviews performed under AT section 401		X
Examinations performed under AT section 501, <i>An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements (AICPA, Professional Standards)</i>	X	
Examinations performed under AT section 601, <i>Compliance Attestation (AICPA, Professional Standards)</i>	X	
Agreed-upon procedures performed under AT section 601		X
Examinations performed under AT section 701, <i>Management's Discussion and Analysis (AICPA, Professional Standards)</i>	X	
Reviews performed under AT section 701		X
Examinations performed under AT section 801, <i>Reporting on Controls at a Service Organization (AICPA, Professional Standards)</i>	X	
<b>Public Company Accounting Oversight Board (PCAOB) Standards</b>		
Audits of non-SEC issuers	X	
<b>Statements on Standards for Accounting and Review Services (SSARS)</b>		
Reviews of financial services		X
Compilations of financial statements with disclosures		X
Compilations of financial statements without disclosures		X
Compilations performed when the compiled financial statements are not expected to be used by a third party (management use only), when no compilation report is issued		X

If you are uncertain about how to classify any engagements, you may consider consulting the AICPA Professional Standards, NEPR, or the AICPA peer review technical staff via [prptechnical@aicpa.org](mailto:prptechnical@aicpa.org) or 919.402.4502 and select option 3.

NOTE: If your firm performs examinations under SSAEs and its last peer review was an Engagement Review, please contact the AICPA at [prptechnical@aicpa.org](mailto:prptechnical@aicpa.org) or 919.402.4502 to determine if you are eligible to have an Engagement Review for your current peer review.

## Engagement Section in a Peer Review

By Barbara E. McGuire, CPA



### Engagement Selection in a System Review

In a system review, engagement selection is a multi-step process. First, the team captain must make a “risk assessment” based on a review of preliminary information obtained from the reviewed firm. That information includes, but is not limited to, the relationship of the firm’s audit hours to total accounting and auditing hours, the size of the firm’s major engagement(s) relative to the firm’s practice as a whole, initial engagements and their impact on the firm’s practice, the industries in which the firm’s clients operate (especially the firm’s industry concentrations), the results of the prior peer review, owners’ continuing professional education (CPE) policies and the firm’s philosophy toward continuing education, the firm’s monitoring policies, adequacy of the firm’s professional library, risk level of the engagements performed, and changes to the firm’s structure or personnel since the prior peer review.

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

The process of engagement selection is not subject to definitive criteria but the standards require that specific types (must selects) and specific audit areas (must covers) be selected. At least one of each of the following types of engagements is required to be selected: Governmental, Employee Benefit Plans, Depository Institutions, Carrying Broker-Dealers, and Service Organizations. The peer reviewer may need to select greater than the minimum of one engagement from these industries in order to attain an appropriately weighted cross section. The AICPA Peer Review Board periodically assesses engagements to determine which may have the most significant public interest of the moment. These engagements are deemed to be must cover engagements. A must cover industry

does not have to be selected for review, however, either the team captain or a team member must have at least recent experience in the industry to aid in the risk assessment process and determination of whether an engagement from the must cover industry should be selected for review. Currently, the list includes HUD, school districts, and state and local government. These engagements, in addition to the must select engagements, are must cover engagements for all firms. A firm may have additional must cover industries based on the concentration of its practice that subjects it to a System Review. Industries that the firm practices 10% or more are considered must cover engagements. If the firm does not have any industries that they practice 10% or more, then the firm’s three largest industry concentrations are considered must cover engagements.

The 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 with the higher assessed levels of peer review risk. A reasonable cross section of a firm’s accounting and auditing practice, not only includes consideration of the specific industries that are required to be selected, but other industries as well. The reviewer needs to carefully consider the industries that the firm has identified in the category of “other audits” when determining whether to select such an engagement(s). A selection consisting solely of public interest industries would not necessarily

represent a reasonable cross section. Other factors to consider in selecting a reasonable cross section may include the number of partners, the number of practice offices, and materiality thresholds of accounting and auditing hours.

A reasonable cross section does not always require that at least one engagement from every level of service provided by the firm be selected for review; however, it often may be appropriate in the circumstances. There is no percentage of coverage that necessarily ensures a reasonable cross section. Therefore, there is a relationship between a risk-based approach and a reasonable cross section when selecting engagements, and in that regard each peer review needs to be considered on a case-by-case basis.

Based on the information obtained above and the risk assessment, the team captain makes a preliminary selection of engagements for review and if the firm is a multi-office firm, the offices which must be visited. If the initial selection does not include certain engagements that would be considered must selects or must covers, the next step in the process is to add them to the engagement selection. The initial selection of the engagements to be reviewed should ordinarily be provided to the reviewed firm no earlier than three weeks prior to the commencement of the peer review procedures at the related practice office or location. This should provide ample time to enable the firm (or office) to assemble the required client information and engagement documentation before the review team commences the review. However, at least one engagement from the initial selection to be reviewed should be provided to the firm once the review commences and not provided to the firm in advance. Ordinarily, based on the nature of the firm's practice and assuming that the engagement would not be automatically anticipated for selection by the reviewed firm, the engagement should be an audit. Otherwise, the engagement should be the firm's next highest level of service where the same criteria can be met. This should not increase the scope of the review but the risk assessment may warrant the selection of more than one surprise engagement.

If the current year's engagement has not been completed and issued, and if a comparable engagement within the peer review year is not available, the prior year's engagement may be reviewed. If the subsequent year's engagement has been completed and issued, the review team should consider, based on its assessment of peer review risk,

whether the more recently completed and issued engagement should be reviewed instead. The reviewer should explain and document in the Summary Review Memorandum key decisions he or she made when choosing not to select any one or more of the following: a level of service, industries in which a significant public interest exists, and industries in which the firm performs a significant number of engagements. This does not give authority to the reviewer to avoid selecting an engagement(s) by simply documenting the reason(s) why he or she did not select a certain engagement(s). Therefore the reviewer should document important considerations regarding the engagement selection process

During the review, if the review team concludes that there was a failure to reach an appropriate conclusion on the application of professional standards, in all material respects, on one or more of the reviewed engagements, the review team should consider whether the application of additional peer review procedures is necessary. If additional procedures are deemed necessary, they may include an expansion of scope to review all or relevant portions of one or more additional engagements. Additional engagements may be in the same industry, supervised by the same individual in the reviewed firm, or otherwise have similar characteristics associated with the engagement in which the reviewer was not able to reach an appropriate conclusion.

If the team captain finds that meeting all of the preceding criteria results in the selection of an inappropriate scope of the firm's accounting and auditing practice, the team captain should consult with the administering entity about the selection of engagements for review.

#### **Engagement Selection in an Engagement Review**

Prior to the review, the reviewer or the administering entity will ask the reviewed firm to provide summarized information showing the number of the firm's compilation and review engagements performed under SSARS and engagements performed under the SSAEs, classified into industry categories. That information should be provided for each partner (or individual of the firm if not a partner) who is

responsible for the issuance of reports on such engagements. On the basis of that information, the review captain 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 (performed under SSARS)
  2. Compilation of historical financial statements, with disclosures (performed under SSARS)
  3. Compilation of historical financial statements that omits substantially all disclosures (performed under SSARS)
  4. Engagements performed under the SSAEs other than examinations
- b. One engagement should be selected from each partner (or individual of the firm if not a partner) responsible for the issuance of reports listed in item (a).
- c. Ordinarily, at least two engagements should be selected for review.

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

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*Barbara E. McGuire is a partner in the firm of Chester M. Kearney, is a peer reviewer and has been a technical reviewer for NEPR since 2013.*

## Broker–Dealer Engagements: Peer Review Implications

The Peer Review Board considered recent regulatory changes and the potential for future changes and clarified the following:

- Engagements subject to permanent inspection by the PCAOB are excluded from the scope of the Peer Review Standards
- Engagements not subject to permanent inspection by the PCAOB that are performed under SAS, SSARS, SSAEs, GAS, or PCAOB Standards are included in the scope of the Peer Review Standards
- Firms that perform engagements under PCAOB Standards or engagements subject to permanent inspection by the PCAOB are required to have their peer reviews administered by the National Peer Review Committee (NPRC).

This clarification applies to the SEC's recent rulings regarding broker dealer engagements. This ruling and the peer review considerations are discussed below.

On July 31, 2013, the SEC finalized its Broker-Dealer Rules. The final rule requires audits of all broker-dealers to be performed under PCAOB Standards. It also requires a new Compliance Report (examination) for carrying BDs and an Exemption Report (review) for non-carrying BDs, both to be performed using PCAOB Standards. These requirements are effective for fiscal years ending on or after June 1, 2014. On October 10, 2013, the PCAOB adopted attestation standards for the purposes of performing the examination of the Compliance Report and the review of the Exemption Report (PCAOB Release No. 2013-007: Final Rule). They also adopted an auditing standard applicable when auditors are engaged to perform audit procedures and report on supplemental information that broker-dealers and others file with the SEC and related amendments to other PCAOB standards (PCAOB Release No. 2013-008: Final Rule).

Audits of all non-SEC issuer broker-dealers are currently subject to inspection by the PCAOB under an interim inspection program. The PCAOB anticipates presenting a rule proposal for a permanent inspection program in 2014 or later. Until such time, audits of non-SEC issuer broker-dealers are included in the scope of peer review. Firms performing these engagements under PCAOB Standards beginning with fiscal years ending on or after June 1, 2014, will be required to have their peer review administered by the National Peer Review Committee.

The reason for this requirement is to ensure that peer reviewers, technical reviewers and committee members considering the peer review reports have the applicable expertise to do so. Firms that are required to have their peer performed by NPRC will be subject to the current NPRC administrative fee structure, viewable at

<http://www.aicpa.org/InterestAreas/PeerReview/Community/NationalPRC/DownloadableDocuments/NPRCFees080113.pdf>.

Enrollment in NPRC would also require that at least one owner of the firm be a member of the AICPA. Refer to the table below for help in determining if your firm is required to have its peer review administered by the NPRC. If you have questions about your firm's peer review administration, please contact NEPR at (603) 623-3513 or the Peer Review Team at (919) 402-4502.

<b>Engagement type</b>	<b>PCAOB permanent inspection scope</b>	<b>Peer review scope</b>	<b>Triggers NPRC administration of firm's peer review</b>
Broker-dealer engagements under AICPA standards	No	Yes	No
Broker-dealer engagements under PCAOB standards, before effective date of PCAOB permanent inspection program	No	Yes	Yes
Broker-dealer engagements under PCAOB standards, upon effective date of PCAOB permanent inspection program	Yes	No	Yes
Engagements of non-issuers under PCAOB standards, not covered by PCAOB permanent inspection	No	Yes	Yes
Engagements for SEC issuers under Government Auditing Standards (e.g. IPSA of CMR), not covered by PCAOB permanent inspection program	No	Yes	No
Engagements under SASs, SSARS, SSAEs, Government Auditing Standards, not covered by PCAOB permanent inspection program	No	Yes	No

## The Effect on a Firm's Peer Review, When Completing Its First Audit, After Having an Engagement Review

When a firm, subsequent to the year-end of its Engagement Review, performs an engagement that would have required the firm to have a System Review, the firm should (a) immediately notify NEPR and (b) undergo a System Review. Refer to page 8 for a chart of which types of engagements firms perform as their highest level of service would require firms to have a System Review instead of an Engagement Review. Performance of even one of these services would subject your firm to the applicable type of peer review. In this situation, the System Review will ordinarily be due 18 months from the year-end of the engagement (for financial forecasts and projections 18 months from the date of report) requiring a System Review or by the firm's next scheduled due date, whichever is earlier. However, NEPR will consider the firm's practice, the year-ends of engagements and when the procedures were performed, and the number of engagements to be encompassed in the review, as well as use its judgment, to determine the appropriate year-end and due date. Firms that fail to immediately inform the administering entity of the performance of such an engagement will be required to participate in a System Review with a peer review year-end that covers the engagement. A firm's subsequent peer review ordinarily will be due three years and six months from this peer review year-end.

The firm should consult with NEPR and/or AICPA staff in the following situations to determine if the firm will be required to undergo a System Review:

- If the firm is scheduled for an Engagement Review that has not yet commenced and will issue a report that will make the firm subject to a System Review
- If the firm is scheduled for an Engagement Review that includes engagements that were previously subject to an Engagement Review but are now subject to a System Review

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### NEPR Meeting Schedule

November 14, 2014  
January 16, 2015  
May 15, 2015  
September 4, 2015

(Dates are subject to change  
- check the NEPR website for  
any revised dates)

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\* Denotes year in which term expires