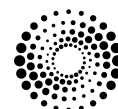


CHECKPOINT LEARNING®

SELF-STUDY CONTINUING PROFESSIONAL EDUCATION

Companion to PPC's Guide to

Quality Control



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Interactive Self-study CPE

Companion to PPC's Guide to Quality Control

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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* along with 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 emailing, faxing, or mailing your completed **Examination for CPE Credit Answer Sheet** for print grading by **April 30, 2023**. Complete instructions for grading are included below and in the test instructions preceding the **Examination for CPE Credit**.

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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.

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COMPANION TO PPC'S GUIDE TO QUALITY CONTROL**COURSE 1****LEADERSHIP RESPONSIBILITIES AND ENGAGEMENT PERFORMANCE
(GQCTG221)****OVERVIEW**

COURSE DESCRIPTION: This interactive self-study course discusses how firms should address two of the elements of quality control in their quality control system. Lesson 1 examines leadership responsibilities for quality within the firm. Lesson 2 takes a look at engagement performance.

**PUBLICATION/
REVISION DATE:** April 2022

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

**PREREQUISITE/
ADVANCE
PREPARATION:** Basic knowledge of quality control

CPE CREDIT: 7 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, 2023**

KNOWLEDGE LEVEL: Basic

Learning Objectives:**Lesson 1—Leadership Responsibilities for Quality within the Firm**

Completion of this lesson will enable you to:

- Recognize how a firm's culture and tone at the top affect its quality control and the quality control system.
- Identify appropriate strategies for dealing with the assignment of management responsibilities; evaluation, compensation, and advancement; the devotion of adequate resources; drafting the firm's quality control policies and procedures; and evaluating the overall adequacy of the quality control system's design.

Lesson 2—Engagement Performance

Completion of this lesson will enable you to:

- Identify the quality control requirements for engagement performance, supervision, and review.
- Determine how a firm should address consultations, differences of opinion, engagement quality control review, and engagement documentation.
- Identify appropriate strategies for drafting the firm's quality control policies and procedures and evaluating the overall adequacy of the design of the quality control system.

TO COMPLETE THIS LEARNING PROCESS:

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Lesson 1: Leadership Responsibilities for Quality within the Firm

INTRODUCTION

QC 10.17 lists *leadership responsibilities for quality within the firm* as the first element of a system of quality control (QC). This QC element serves as an over-arching element for the other QC elements.

A concerted and focused effort is needed to prioritize quality throughout the firm. One of the most successful ways to establish and maintain a high level of quality within the firm is through the example set by firm leadership. When firm leadership considers the ethical and quality aspects of a situation as part of its decision-making process, others in the firm will also be more likely to do so. The importance of leading by example is further discussed throughout this lesson.

Learning Objectives:

Completion of this lesson will enable you to:

- Recognize how a firm's culture and tone at the top affect its quality control and the quality control system.
- Identify appropriate strategies for dealing with the assignment of management responsibilities; evaluation, compensation, and advancement; the devotion of adequate resources; drafting the firm's quality control policies and procedures; and evaluating the overall adequacy of the quality control system's design.

Authoritative Literature

This lesson describes the firm's responsibilities to promote an internal culture of quality. QC 10, *A Firm's System of Quality Control*, is the primary source for this information. 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. Likewise, the authoritative guidance in AT-C 105, *Concepts Common to All Attestation Engagements*, and AR-C 60, *General Principles for Engagements Performed in Accordance with Statements on Standards for Accounting and Review Services*, put the responsibility for the quality of attestation and SSARS engagements primarily on the engagement partner.

Requirements

The requirements pursuant to the authoritative literature discussed in the previous paragraph that relate to the leadership responsibilities for quality are detailed in Exhibits 1-1 through 1-4.

Exhibit 1-1

Requirements for Leadership Responsibilities for Quality QC Policies and Procedures under QC 10

Requirements	QC 10
The firm should establish policies and procedures to promote an internal culture based on the recognition that quality is essential in performing engagements. Such policies and procedures should require that the firm's leadership assumes the ultimate responsibility for the firm's system of quality control.	QC 10.19
The firm should establish policies and procedures that provide it with reasonable assurance that any individuals who are assigned operational responsibility for the firm's system of quality control have sufficient and appropriate experience and ability, and the necessary authority, to assume that responsibility.	QC 10.20

Exhibit 1-2

Requirement for Leadership Responsibilities for Quality QC Procedures under AU-C 220

Requirement	AU-C 220
The engagement partner should take responsibility for the overall quality on each assigned audit engagement. The performance of certain procedures may be delegated to other members of the engagement team and the engagement partner may rely on the firm's system of quality control.	AU-C 220.10

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.	AT-C 105.35

Exhibit 1-4

SSARS Engagement-level QC Requirement under AR-C 60

Requirement	AR-C 60
The engagement partner should take responsibility for the overall quality on each assigned SSARS engagement.	AR-C 60.21(a)

Summary of the Lesson

This lesson is divided into the following topics:

- The firm's internal culture and tone at the top.
- Assigning management responsibilities.
- Policies for evaluation, compensation, and advancement.
- Devoting adequate resources.
- Drafting quality control policies and procedures.
- Evaluation of the overall adequacy of the QC system's design.
- Monitoring leadership compliance with the firm's policies and procedures.

THE FIRM'S INTERNAL CULTURE AND TONE AT THE TOP

QC 10.19 requires firms to establish policies and procedures to promote an internal culture that understands quality is fundamental in performing engagements. Providing quality services is more than just a lofty goal for a firm. A commitment to quality is critical to—

- Keeping clients satisfied.
- Delivering a valued product.
- Elevating the professional reputation of the firm.
- Meeting the public interest responsibilities of accounting firms.

The guidance at QC 10.A4 indicates that the actions taken by the firm's leaders significantly influence the internal culture of the firm. To effectively promote a quality-oriented internal firm culture, it is important for all levels of management to provide clear, consistent, and frequent actions and messages that emphasize the firm's quality control policies and procedures, the objective of which is to perform work that complies with professional standards and applicable legal and regulatory requirements, and issue reports that are appropriate in the circumstances.

QC 10.A5 further explains that it is important for firm leadership to understand that the firm's business strategy is subject to the overall requirement for the firm to achieve the objectives of its system of quality control in all engagements performed. The leadership of the firm can promote an internal culture of quality by, among other things—

- Establishing policies and procedures over performance evaluation, compensation, and personnel advancement that reflect the firm's commitment to quality.
- Assigning management responsibilities in such a way that the firm's system of quality control is not sacrificed for firm profitability.
- Providing sufficient and adequate resources to support the firm's quality control initiative.

Firm Management Is Responsible for the Firm's System of Quality Control

Promoting an internal culture with a commitment to quality requires a sincere commitment on the part of firm management to drive the initiative. Accordingly, the standard requires firm management to take responsibility for the firm's system of quality control. In fact, the determination of whether a 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. Assigning management responsibility for the day-to-day operation of the firm's system of quality control is discussed in more detail later in this lesson.

In the context of this QC element, QC 10.19 indicates that firm leadership is the managing partner or board of managing partners, CEO, or equivalent individual(s). This course interchangeably uses the terms chief executive officer, managing board of partners, managing partner, firm leadership, or firm management to represent those individuals ultimately responsible for the firm's system of quality control. Within a given firm, the individual(s) with the highest level of authority should be assigned the ultimate responsibility for the firm's quality control system.

Setting the Tone at the Top

For firms that do not make quality a top priority, getting the job done *on time* is generally the primary goal, and getting the job done *right* is secondary. Yet, a commitment to quality ensures that both of these goals are met, without sacrificing either. Changing the firm culture from thinking only about merely getting the job done to a real awareness of quality often necessitates a transformation. Many understand that the best way to accomplish such a transformation is to lead by example. The culture of a firm is defined by the actions and verbal and nonverbal messages conveyed by those individuals who comprise firm leadership to everyone with whom they come into contact, both internal and external to the firm. This concept is often known as the *tone at the top*.

As previously mentioned, leadership responsibilities for quality (or tone at the top) serve as the over-arching element for the other QC elements. In a webcast presented by the AICPA, the concept was illustrated by stating that when listing the six QC elements in order of importance, tone at the top is the first five QC elements, with the remaining QC elements tied for 6th place. *Tone at the top* is an intangible concept with very tangible consequences. It has been defined as—

- A standard set by firm leadership against which all performance is measured.
- The ambient culture.
- The force that impacts behavior in spite of actual documented policies.
- An unseen hand that guides the behavior of partners and staff when no one is looking.
- The level of commitment to quality of client service.

Setting the tone at the top is at the core of creating a firm commitment to quality. This means that firm management has the ability and opportunity to form firm culture by sending clear, consistent, and frequent actions and messages to personnel at all levels. In essence, setting the tone at the top provides direction for all staff, clients, vendors, suppliers, and other parties that deal with the firm. In defining its commitment to quality, the leadership of a firm sets the appropriate tone by—

- Emphasizing the importance of doing the right thing on behalf of the public interest.
- Demonstrating the importance of creating and maintaining a good public reputation.
- Ensuring partners and staff have sufficient time and resources to solve engagement challenges.
- Following the intent, as well as the stipulated guidance, of professional standards and applicable legal and regulatory requirements.
- Displaying enthusiasm and sincerity in communicating its commitment to a quality initiative.
- Demonstrating consistency.

Transformation is a two-part process. First, firm personnel need to understand what is expected of them. As previously mentioned, in promoting a quality-oriented firm culture, firm leadership needs to send clear, consistent, and frequent actions and messages. Such actions and messages may be communicated through the following means (not intended to be all-inclusive):

- Mission statements, codes of conduct, or other "Who We Are" communications.
- Leadership by example.
- Client roster and acceptance/continuance policies and procedures.

- Training offerings and opportunities, including ethics training and training on the firm's QC policies and procedures.
- Performance appraisals.
- Meeting agendas.
- Formal and informal dialogue.
- Newsletters (internal and client-directed).
- Web-based sessions focusing on quality issues.
- Email updates to help staff remain current in issues including technical matters, technology, best practices, ethics, practice management, and client news.
- Quality of interaction and communication between firm management and firm personnel.
- Online portal for anonymous submission of possible quality issues or concerns.
- Recruiting materials.
- Criteria used to select recruitment candidates.
- Extent and quality of community involvement.

The second part of the two-part transformation process is the appreciation that quality work is rewarded and, equally important, that noncompliance is not acceptable and will not be ignored. The character and contributions of all personnel who are recognized or promoted need to demonstrate the qualities firm management purports to value. Incentive systems can be designed to emphasize a commitment to quality. For example, performance appraisals can play an important part in the transformation process by evaluating whether personnel are committed to quality and to following the firm's quality control policies and procedures.

AICPA Tone-at-the-Top Action Plan. The AICPA has a toolkit that firms can use to assist in developing a tone-at-the-top action plan. The toolkit recommends eight actions to follow and refers to other AICPA-developed tools that might further assist with most of those actions. The responsibility for each action is to be assigned to a specific individual in the firm. The toolkit is available to AICPA members from the AICPA's "Invigorate the Focus on Quality" web page at us.aicpa.org/interestareas/privatecompaniespracticesection/qualityservicesdelivery/keepingup/invigorate-the-focus.

Determining the Appropriate Firm Management Philosophy and Operating Style

As management sets the *tone at the top* for behavior within the firm, the philosophy and operating style displayed by firm management impacts how the firm is managed, including its approach to accepting and managing business risks. For example, organizations that successfully embrace risk may have a different philosophy from organizations whose activities lead to financial or regulatory costs. Among the factors relating to firm management's philosophy and operating style are—

- *Management Style (Formal or Informal).* Firms with a formal management style generally have more structured policies and procedures (usually in detailed written form), performance indicators, etc. A firm with an informal management style often communicates using personal contact with supervisors and managers in one-on-one meetings or group discussions, rather than having as many written firm directives.
- *Attitude (Conservative or Aggressive).* The attitudes of firm management toward firm profitability may play a role in determining whether the firm is conservative or aggressive when evaluating a client's selection of accounting principles or how the client develops its accounting estimates.

Firm management's philosophy and operating style determine acceptable behavior and expectations for each employee, and are communicated firm-wide through firm management's actions and policies. A firm wishing to

create an environment that demands and values quality can succeed only by creating a culture with a strong value system founded on a commitment to quality.

A Commitment to Quality Begins with Creating an Ethical Firm Culture

At the core of an effective quality control system is integrity. Adherence to professional standards and applicable legal and regulatory requirements of an engagement means more than merely directing the staff to follow the rules to produce a high-quality work product. It entails developing a culture where ethics and integrity guide personnel in every decision affecting an engagement. If ethics and integrity are not foundational values of the firm, the firm will have difficulty establishing an internal culture that values quality. To promote an ethical firm culture, firms can establish a number of policies and procedures that—

- Establish a code of conduct.
- Create a positive work environment.
- Result in hiring and promoting ethical employees.
- Provide ethics training.
- Deal with noncompliance.

Those actions are further discussed in the following paragraphs.

Establish a Code of Conduct. Firm management can effectively communicate the firm's ethical values by example. However, it is also important that firm management communicate ethical values and behavioral standards orally and in writing. One way those values and standards can be communicated is through a written code of conduct (or other description of the firm's value system, such as an ethics policy or a statement of guiding principles). A code of conduct emphasizes the importance of integrity and ethical behavior and is often used by large international firms. While not as commonplace in smaller firms, much of the guidance provided in this section can be tailored to meet the needs of the specific firm, depending on its size, needs, and resources.

The firm's code of conduct needs to reflect the core values of the firm and guide employees to make appropriate decisions throughout their workday. In establishing the firm's code of conduct, participation by employees and firm management, especially in smaller firms, will create a document that everyone can feel proud of and take ownership in.

To be most effective, the firm's code of conduct needs to be regularly communicated and reiterated to all employees. Firms can conduct formal or informal training to further sensitize employees to potential ethical issues. New employees may be taught the firm's values from the outset by introducing them to the code of conduct during new employee orientation. In addition, the firm needs to conduct an ongoing evaluation of compliance with the code of conduct to ensure that noncompliance is addressed in a timely manner.

Many of the ethical problems arising in a firm are not clear-cut, but involve gray areas, where the proper course of action may be ambiguous and uncertain. The firm's code of conduct can be a resource to help employees solve ethical dilemmas. Codes of conduct often include the following topics:

- Guidelines for employee conduct while on the job.
- Disclosure of conflicts of interest.
- Discussion of maintaining proper relationships with clients, suppliers, and other vendors.
- Definition and examples of unethical behavior.
- Rules governing employee use of firm assets for personal activities.
- Procedures for how to report fraud or unethical behavior.

It is important to note that simply establishing a code of conduct does not ensure that employees will follow its provisions. However, it is more likely that employees will follow a code of conduct when firm management embraces it and shows that strong ethical conduct is expected.

As previously noted, formal codes of conduct are more commonplace in larger firms. In smaller firms, the example set by the managing partner regarding ethical behavior is usually indicative of the firm's values. With substantial managing partner involvement, there is often no need for extensive written policies and procedures manuals. Also, because there are fewer levels of firm management in smaller firms, effective communication may be easier to achieve. Communication often occurs through daily discussions with firm management. Higher visibility and more daily contact with firm management within the informal organizational structures of most small firms generally result in open communications. The managing partner might also instill a culture of sound integrity and ethical values through some of the following approaches:

- Day-to-day firm dealings, decisions, and actions of the managing partner with staff, employees, clients, and other external parties demonstrate integrity and ethical values on a consistent basis. Employees should not witness any discrepancy between the message and the managing partner's own actions.
- The managing partner holds all levels of personnel equally accountable and responsible for ethical behavior and integrity. No exceptions are made for partners or for family members of the managing partner employed by the entity.
- The managing partner and partner group demonstrate a serious attitude when dealing with all reported unethical behavior, including prompt investigation and appropriate actions to remedy the situation. Firm management is consistent in its approach in dealing with complaints, including the treatment of individuals who violated ethical expectations.
- Employees who demonstrate sound integrity and ethical values are rewarded and recognized through performance reviews and/or public acknowledgement.

Create a Positive Workplace Environment. Establishing and maintaining a positive workplace environment is another important factor needed to create an ethical workforce that promotes quality. Firms need to take definitive steps to create a work environment where employees have a clear, common understanding of right and wrong behavior and feel free to discuss and ask questions about ethical issues, as well as to report violations. If the firm does not have a positive work environment, the following significant problems may result:

- Increased risk of employees making unethical decisions.
- Increased tendency of employees to report violations to outside regulatory authorities because they lack an adequate internal forum.
- Inability to recruit and retain top people.
- Diminished reputation in the community.
- Potential legal exposure.
- Loss of competitive advantage in the marketplace.

Additionally, firms lacking a positive working environment tend to create added stress for employees, potentially leading to poor employee morale. Poor employee morale can jeopardize individuals' commitment to quality in the performance of engagements. Employees working in a positive environment are less likely to develop poor employee morale as a result of normal job-related challenges. Situations that can create or indicate a negative workplace environment include the following:

- Firm management's lack of concern about issues or problems raised by employees.
- Negative feedback or a lack of recognition for outstanding job performance.
- Low organizational loyalty.

- Pressure to meet unrealistic performance goals.
- Below-market compensation.
- Perceived inequities within the firm.
- Poor training and/or deficient advancement opportunities.
- Employees fear delivering news of adverse conditions to firm management.
- Inadequate firm or management-level communication practices or methods.
- Rapid turnover of employees.
- Operating under perpetual crisis conditions.

A positive workplace environment can be achieved by combining the firm's objectives with employees' needs to be valued and appreciated. A basic way to achieve this combination is to encourage and empower employees to support the firm's values and code of conduct. Individuals ordinarily feel valued when they are asked to participate in the decision making process and know their input will be sincerely considered. Some specific ways to achieve a more positive work environment include the following:

- Providing access to a choice of projects and engagements.
- Instituting reward and recognition systems that reinforce a commitment to quality.
- Implementing a team approach and collaborative work atmosphere.
- Offering thoughtfully designed compensation, training, and employee assistance programs.
- Setting achievable goals for professional staff.

Consider the following detrimental situation that firm management can easily create by setting unrealistic goals for its staff. If firm management establishes unrealistic goals for its employees and pressures them to achieve those goals, the employees are put in a difficult position. Firm management has effectively forced its employees to choose between objectionable options—to either fail, or to behave unethically by cheating to reach the goal. Failure generally results in employees having negative feelings about themselves. Employees who fail to achieve firm objectives probably receive little or no increases in pay or promotions. Further, when the failure is due to firm management setting unrealistic objectives, employees at all levels may begin to have negative feelings toward the firm and its management. As an alternative to failing, some employees may choose to circumvent the firm's policies and procedures.

Firm management can avoid this situation by setting challenging but realistic goals. In addition, firm management needs to communicate to its staff and other personnel that, while employees pursue management targets, the firm expects adherence to QC policies and procedures at all times. Such a statement clearly tells employees that integrity is a requirement. While performance incentives or targets may be necessary to motivate staff sufficiently, incentives and targets can be designed to emphasize positive and ethical behavior, instead of being counterproductive and providing incentives or temptations for unethical actions.

Conducting staff surveys can assist the firm in determining how its personnel feel about the firm. One of the most important aspects of conducting a firm survey is objectively evaluating the results and then making needed changes based upon those results. Firms need to be cautious of conducting staff surveys and not taking the results seriously, as such actions would be perceived negatively by firm personnel and suggest that firm leadership does not truly value staff member's opinions.

Hire and Promote Ethical Employees. If a firm is to be successful in promoting a commitment to quality, it needs to establish and maintain a policy of hiring and promoting individuals with high levels of integrity.

Provide Ethics Training. In addition to training new employees about the process involved to perform their new job responsibilities, training all employees about the firm's values and its code of conduct at the time they are hired clearly explains what is expected of them with regard to matters such as—

- Their responsibility to communicate certain matters.
- The types of matters to be communicated, as well as examples of each type of matter.
- How to communicate those matters.

To keep the significance of the firm's values and its code of conduct uppermost in the minds of all staff, this course suggests periodic refresher ethics training. Subsequent refresher training may be more specific to an employee's level within the firm, geographic location, and/or job function and responsibilities. In addition to providing periodic refresher training on the firm's values and code of conduct, the Uniform Accountancy Act (UAA) stipulates that CPAs complete no less than four hours of ethics-related CPE during each three-year (120-hour) period. As a result of the UAA rule, many states require a stated 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. All ethics training is strengthened by firm management's constant and consistent affirmation about its expectation of employees' responsibility to follow the firm's values and code of conduct.

Deal with Noncompliance. Dealing with noncompliance in a timely manner and taking swift action to discipline (or even terminate in extreme cases) staff who do not comply with the quality initiative will send a clear message to other personnel. If such a circumstance occurs, the firm can use the situation to its advantage by clearly reaffirming management's expectations regarding quality and integrity. (The disciplined employee's name should remain confidential in any such communications.) It is generally the perception of getting caught that modifies an employee's behavior.

In response to an alleged lapse of integrity, the following actions ordinarily can be taken:

- Conduct a thorough investigation.
- Administer appropriate and consistent actions against violators of the firm's code of conduct.
- Assess and strengthen controls circumvented or overridden that allowed the action to occur.
- Reinforce the firm's values, code of conduct, and expectations through communication and training.

Exhibit 1-5 has been adapted from COSO's *Internal Control over External Financial Reporting: A Compendium of Approaches and Examples*, which was issued in connection with COSO's *Internal Control—Integrated Framework*. Exhibit 1-5 provides points of focus that are often present, along with approaches that might be applied for the COSO principle of integrity and ethical values. Certain approaches listed in the exhibit may relate to one or more points of focus.

Exhibit 1-5**Points of Focus and Approaches for Integrity and Ethical Values**

Points of Focus	Approaches	Explanation
<ul style="list-style-type: none"> • Establishes standards. • Sets the tone. • Evaluates adherence. • Addresses deviations. 	Establishes standards of conduct.	<ul style="list-style-type: none"> • Firm management communicates and reinforces that personnel will be held accountable for their conduct. • Standards of conduct permeate the entire organization. • Firm management encourages an environment that cultivates personnel questioning the application of standards. • Management develops and uses performance appraisals and incentives to promote ethical behavior and diminish temptations. • Firm management explicitly communicates the consequences and demonstrates intolerance of ethical violations throughout the firm. • Firm management maintains a record of training provided to new and existing staff on standards of conduct and CPE for both internal and external use.
	Leads by example with regard to integrity and ethics matters.	<ul style="list-style-type: none"> • Firm management consistently communicates and embodies the standards of conduct. • Integrity and ethics are demonstrated in firm management's day-to-day actions and decision making. • Firm management demonstrates fair and honest interactions with external parties. • Firm management investigates and resolves all deviations from the standards of conduct.

Points of Focus	Approaches	Explanation
	Evaluates internal personnel and external parties for adherence to the firm's standards of conduct.	<ul style="list-style-type: none"> • Firm management evaluates the effectiveness of training and ethics certification processes. • Firm management investigates financial and operational anomalies as potential indicators of financial fraud or misconduct. • Firm management utilizes and analyzes an on-line portal for submissions of potential financial fraud or misconduct. • Firm management continuously monitors and evaluates internal control processes, specifically the financial data transferring process with external parties, to ensure that continued compliance is occurring.
	Develops processes for reporting and acting on deviations from the standards of conduct.	<ul style="list-style-type: none"> • Firm management ensures the independence between individuals under investigation and individuals conducting the investigation. • Firm management prioritizes deviations based on selected criteria. • Firm management thoroughly investigates possible violations. • Firm management maintains documentation in support of violation investigations. • Firm management addresses and remediates violations in a timely and consistent manner in accordance with prescribed guidelines. • Firm management communicates deviations, investigations, corrective actions, and waivers to personnel under investigation and other firm personnel as necessary. • Firm management determines the need for corrective actions and/or prevention plans to avoid similar violations in the future.

SOURCE: Adapted from COSO's *Internal Control over External Financial Reporting: A Compendium of Approaches and Examples*.

SELF-STUDY QUIZ

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

1. What is one way that firm leadership can promote an internal culture of quality?
 - a. Monitoring resources so that too much is not dedicated to the quality control initiative.
 - b. Assign management personnel to maximize the firm's profits.
 - c. Assign one member of leadership to promote the firm's quality control message.
 - d. Establish appropriate policies and procedures for compensation and advancement.
2. Which of the following firms has a tone at the top that embraces quality?
 - a. The manager of Rogers CPAs uses questionable methods to save clients money.
 - b. The CEO of Hawkeye Accountants allows staff members time to solve engagement challenges.
 - c. The managing partner of Starkwell CPAs follows the letter of the law, but not always its intent.
 - d. The owner of Alias Accounting leaves its quality initiative unspoken unless a need arises.
3. A firm that does not foster a positive working environment for its employees is more likely to have which of the following?
 - a. A competitive edge in the marketplace.
 - b. Employees that make ethical decisions.
 - c. Possible legal exposure to the firm.
 - d. Good employee morale.

SELF-STUDY ANSWERS

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

1. What is one way that firm leadership can promote an internal culture of quality? **(Page 5)**
 - a. Monitoring resources so that too much is not dedicated to the quality control initiative. [This answer is incorrect. To demonstrate an internal culture that upholds quality, firm leadership should provide sufficient and adequate resources to support the firm's quality control initiative.]
 - b. Assign management personnel to maximize the firm's profits. [This answer is incorrect. One way firm leadership can promote an internal culture of quality is to assign management responsibilities in such a way that the firm's system of quality control is not sacrificed for firm profitability.]
 - c. Assign one member of leadership to promote the firm's quality control message. [This answer is incorrect. The guidance at QC 10.A4 indicates that the actions taken by the firm's leaders significantly influence the internal culture of the firm. To effectively promote a quality-oriented internal firm culture, it is important for *all levels* of management to provide clear, consistent, and frequent actions and messages that emphasize the firm's quality control policies and procedures.]
 - d. **Establish appropriate policies and procedures for compensation and advancement.** [This answer is correct. QC 10.A5 explains that it is important for firm leadership to understand that the firm's business strategy is subject to the overall requirement for the firm to achieve the objectives of its system of quality control in all engagements performed. One way firm leadership can promote an internal culture of quality is by establishing policies and procedures over performance evaluation, compensation, and personnel advancement that reflect the firm's commitment to quality.]
2. Which of the following firms has a tone at the top that embraces quality? **(Page 6)**
 - a. The manager of Rogers CPAs uses questionable methods to save clients money. [This answer is incorrect. A tone at the top that embraces quality would be emphasizing the importance of doing the right thing on behalf of the public interest. Doing anything it takes to save money for clients would not always reflect the public's best interest.]
 - b. **The CEO of Hawkeye Accountants allows staff members time to solve engagement challenges.** [This answer is correct. Setting the tone at the top is at the core of creating a firm commitment to quality. This means that firm management has the ability and opportunity to form firm culture by sending clear, consistent, and frequent actions and messages to personnel at all levels. In defining its commitment to quality, the leadership of a firm can set the appropriate tone by, among other things, ensuring partners and staff have sufficient time and resources to solve engagement challenges.]
 - c. The managing partner of Starkwell CPAs follows the letter of the law, but not always its intent. [This answer is incorrect. The tone at the top of Starkwell CPAs is not embracing quality. To do so, its leadership needs to follow the intent, as well as the stipulated guidance, of professional standards and applicable legal and regulatory requirements.]
 - d. The owner of Alias Accounting leaves its quality initiative unspoken unless a need arises. [This answer is incorrect. An appropriate tone at the top is a firm that displays enthusiasm and sincerity in communicating its commitment to a quality initiative. Alias Accounting's commitment to quality is an unspoken mystery to firm personnel if not communicated by the owner.]

3. A firm that does not foster a positive working environment for its employees is more likely to have which of the following? **(Page 9)**
- a. A competitive edge in the marketplace. [This answer is incorrect. One of the problems that occurs when a firm does *not* have a positive working environment is the loss of its competitive advantage in the marketplace.]
 - b. Employees that make ethical decisions. [This answer is incorrect. When they are not part of a positive working environment, employees are more likely to be able to justify the risk of making unethical decisions, which would be a problem for a firm's commitment to quality.]
 - c. **Possible legal exposure to the firm. [This answer is correct. Establishing and maintaining a positive workplace environment is an important factor needed to create an ethical workforce that promotes quality. The significant problems that can arise if a firm does not have a positive work environment include a diminished reputation in the community and potential legal exposure.]**
 - d. Good employee morale. [This answer is incorrect. Firms lacking a positive working environment tend to create added stress for employees, potentially leading to *poor* employee morale. Poor employee morale can jeopardize individuals' commitment to quality in the performance of engagements.]

ASSIGNING MANAGEMENT RESPONSIBILITIES

QC 10 provides three examples of actions that firm leadership can take to promote an internal culture of quality. Assigning management responsibilities in such a way that the firm's system of quality control is not sacrificed for firm profitability is discussed in this section. The other two examples of actions are discussed later in this lesson.

A Commitment to Quality Is Fundamental to the Firm's Business Strategy

The conflict that can exist between a firm's dual goals of quality and profitability cannot be overstated. It was an arrogant focus on profit over integrity that destroyed the reputation of Arthur Andersen & Co. and caused the demise of the once-prestigious international firm. QC 10.A5 explains that promoting an appropriate internal culture includes, among other things, assigning management responsibilities to prevent commercial considerations overriding the quality of work performed, specifically addressing the balancing act that all firms face. While the consequences to most firms that are associated with major company fraud may not be on the massive scale as the Arthur Andersen & Co. and Enron scandals, firms should recognize that they place their existence in jeopardy by promoting compensation and incentive systems that reward selling services over the quality of services rendered.

Firms need to emphasize that the overriding objective of the accounting and auditing practice for all firms is the achievement of high-quality engagements, and that this commitment to quality needs to be ingrained in the firms' business strategy. A commitment to quality can be reflected in a firm's business strategy by—

- Making a commitment to quality a key objective of the firm's strategy.
- Linking partner compensation and incentives to quality measures as well as other firm goals.
- Incorporating the quality objective in the firm's operations manual.
- Integrating the quality objective in organizational documents.
- Involving firm management with quality control responsibility in developing firm strategy.
- Treating the costs of maintaining the firm's system of quality control as an investment in the firm rather than as costs that can be cut to make the firm more profitable.
- Setting up quality control personnel independent of engagement management.
- In setting the tone at the top, encompassing the idea that quality is crucial to firm survival and necessary for growth.
- Selectivity in client and engagement acceptance and continuance decisions.
- Ensuring that engagement time budgets are reasonable and realistic.
- Requiring that partners sign membership agreements that incorporate a commitment to provide quality service to all clients.
- Encouraging partners and staff to participate in leadership roles of professional organizations such as accountancy, oversight and regulatory bodies (as allowed), and business-oriented groups.
- Communicating common engagement methodology to all partners, staff, or offices.

A strong focus on quality in business practices can assist in placing a firm's short-term operating goals in perspective with the long-term goals and overall beliefs of the firm and firm management.

Special Considerations—Audit Engagements

AU-C 220 addresses the specific responsibilities of the auditor regarding quality control procedures for an audit of financial statements. AU-C 220.10 requires the engagement partner to take responsibility for the overall quality of each audit engagement to which they are assigned. In fulfilling this responsibility, the engagement partner is allowed

to delegate the performance of certain procedures to, and use the work of, other members of the engagement team. The engagement partner may also rely upon the firm's system of quality control.

AU-C 220.A3 explains that, in demonstrating responsibility for the overall quality on each audit engagement, the engagement partner's actions and messages sent to other members of the engagement team can emphasize the importance to audit quality of—

- Adhering to professional standards and applicable legal and regulatory requirements;
- Complying with the firm's quality control policies and procedures;
- Issuing appropriate reports; and
- Enabling the engagement team to raise concerns without fear of reprisal.

The engagement partner also demonstrates responsibility for the overall quality on each audit engagement when they emphasize the fact that quality is essential in performing audit engagements. Just as firm management sets the tone at the top by their actions and communications, the engagement partner sets the tone for the conduct of the audit by their actions and communications to the engagement team.

Special Considerations—Attestation Engagements

AT-C 105 provides guidance that is common to all attestation engagements, including quality control-related guidance. Specifically, AT-C 105.35 stipulates an overarching requirement for leadership quality by assigning the responsibility to the engagement partner to ensure quality on each attestation engagement. The overarching requirement is followed with a list of specific quality-related tasks that the engagement partner is expected to be responsible for. Those additional tasks include the acceptance and continuance decision and certain engagement performance procedures, the requirements of which are further discussed in Lesson 2.

Special Considerations—SSARS Engagements

AR-C 60, among other things, provides engagement-level quality control requirements for the partner on a SSARS engagement. The engagement-level quality control requirements of AR-C 60.20–.24 include several of the QC elements found in QC 10, one of which is leadership responsibilities for quality.

AR-C 60.21(a) requires the engagement partner to take responsibility for the overall quality of each SSARS engagement to which they are assigned. AR-C 60.A40 stresses that engagement teams have a responsibility to implement quality control procedures that are appropriate to the engagement. Additionally, according to AR-C 60.A41, the engagement partner needs to emphasize the fact that quality is essential when performing an engagement under the SSARS, including the importance of—

- Adhering to professional standards and regulatory and legal requirements when performing work;
- Complying with the firm's quality control policies and procedures;
- Issuing reports that are appropriate in the circumstances; and
- Allowing the engagement team to raise any concerns without fear of reprisal.

POLICIES FOR EVALUATION, COMPENSATION, AND ADVANCEMENT

As previously mentioned, 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 firm's commitment to the objectives of the system of quality control. Again, critical in this effort is the tone set by firm management.

The appropriate tone is set when the firm's employee appraisal system clearly reflects the link between an employee's demonstration of a commitment to quality and the potential benefits and rewards. Employees see evidence of the firm's commitment to quality when—

- Performance measurements are communicated clearly to all levels of personnel.
- Performance evaluations are given timely.
- Performance criteria include evaluations of staff with regard to a firm's stated quality objectives.
- Performance evaluations provide opportunities to create a development plan for employees so that the employee can be given appropriate training to meet quality criteria.
- Performance criteria do not give unreasonable weight to meeting engagement deadlines or time budgets.
- Time management training is provided to partners and supervisory staff.
- Quality control leadership is recognized.
- Partners are expected to devote sufficient time and attention to adherence to the firm's system of quality control on their engagements and are rewarded monetarily for doing so.
- Partners and staff are not reprimanded for spending extra time on critical issues.
- Partners and staff are held accountable for deficiencies in meeting professional standards and applicable legal and regulatory requirements or complying with the firm's QC policies and procedures.
- The resumes of new recruits reflect a commitment to excellence in academics, an aspiration to serve, and a desire to learn.
- Employees who are promoted exhibit the characteristics the firm purports to value.

DEVOTING ADEQUATE RESOURCES

Designation of a Quality Control Director

Providing adequate firm resources to develop, implement, and maintain a quality control initiative can be viewed as an investment of the firm—an investment in its people, its long-term goals, and its stability. The alternative to not having a quality initiative is a diminished reputation leading to fewer clients and, ultimately, an overall decline in long-term firm value.

QC 10.20 requires the firm's policies and procedures to provide reasonable assurance that the individual(s) assigned by management to oversee the firm's quality control system has sufficient and appropriate experience and ability, as well as the authority necessary to assume that responsibility. Additionally, QC 10.A6 explains that sufficient and appropriate experience and ability is needed to identify and understand quality control issues and develop appropriate policies and procedures. Further, a sufficient level of authority is needed to ensure that the policies and procedures can be implemented.

QC 10.14 indicates that applying and complying with relevant requirements of QC 10 requires the individuals within the firm who are responsible for establishing and maintaining the firm's system of quality control to have an understanding of the entire QC standard. A comprehensive understanding of QC 10 is necessary to ensure that the objective of the standard and the proper application of its requirements are met.

Depending on the size of the firm or the breadth of the initiative, the quality control effort may be led by an individual or guided through a team. For the purposes of this course, the individual chosen to lead the quality control effort will be referred to as the quality control director.

Consistent with the concept of setting the tone at the top, it is imperative that the quality control director be provided with the resources necessary to achieve a successful result. The most important of those resources include sufficient authority and adequate time and assistance.

Sufficient Authority. The quality control director needs to have sufficient authority and decision-making power to both implement the policies and procedures necessary for a firm's successful commitment to quality and also overcome unreasonable objections of even high-ranking members of the firm. When there are disagreements within the firm relating to the quality control system that cannot be resolved one-on-one, the burden to demonstrate the validity of their case needs to be on the disagreeing members of the firm (rather than the quality control director). This burden-of-proof approach sends a message to everyone in the firm that the firm is committed to the QC system and that the quality control director has the backing of firm management.

Adequate Time and Assistance. The quality control director also needs to have adequate time to devote to the quality initiative, which may necessitate relief from some existing responsibilities. It is not reasonable to expect this individual to direct the quality control effort in addition to carrying a full client and administrative load. Providing a reasonable level of assistance to this individual is appropriate. In larger firms, it would be unrealistic to assume that the project could be managed single-handedly. In fact, certain administrative aspects of the effort, such as accumulating existing forms and materials, would be an inefficient use of this partner's time. Firms may designate other individuals to support the quality control initiative.

Desirable Characteristics of a Quality Control Director. To have a reasonable chance of success, the quality control director needs to possess a certain mix of qualities. These qualities include—

- *Technical Expertise.* Technical proficiency in accounting, auditing, quality control, peer review, and other professional standards is generally assumed to be a trait possessed by the individual who fills the role of quality control director. Someone lacking such proficiency would almost certainly be consigned to failure, and such a choice would also cause the commitment of the firm to the project to be called into question by partners and staff.
- *A High Level of Personal Commitment to Quality.* The quality control director needs to believe in the importance of the development of a quality control system for the firm. If this individual does not believe in the project, it is unlikely that they will be able to lead the firm through the process.
- *A First-hand Knowledge of the Firm.* It is important that the quality control director be intimately familiar with the firm and how it operates, including having a fairly thorough understanding of the firm's partners, staff, clients, and the nature of the firm's practice.
- *A Track Record of Accomplishments.* Ideally, the quality control director is recognized throughout the firm as a leader who gets things accomplished. Generally, a thoughtful, contemplative technician might be ill-suited to lead the effort. A strong personality with a reputation for getting the job done is often the preferred choice, assuming the individual has the other technical qualities described above.

Other Quality Control Personnel

While the quality control director may have the oversight responsibility for the firm's quality control system and quality initiative, in many firms, it requires more than this one individual to accomplish the task. All individuals assigned a responsibility for the firm's quality control system should have appropriate experience and knowledge, adequate time, and the necessary authority to perform the responsibility.

Ethics Partner. Another individual often involved in the firm's quality control system effort is an individual designated as the ethics partner. The ethics partner has the responsibility for overseeing firm and personnel compliance with relevant ethical requirements. This responsibility includes overseeing the administration of all firm independence-related matters, as well as integrity and objectivity issues in compliance with the AICPA *Code of Professional Conduct*.

AICPA Audit Quality Center Partners. If the firm is a member of either the AICPA Governmental Audit Quality Center or the AICPA Employee Benefit Plan Audit Quality Center, the firm must designate an audit partner to have firm-wide responsibility for the quality of governmental or employee benefit plan audits. Such partners must meet the requirements of that position. Those individuals also support the firm's quality control system and quality initiative.

Recruitment and Hiring Manager. Every firm has at least one individual responsible for staffing decisions, which this course has termed a *recruitment and hiring manager* (although generally, only larger firms may actually have an

employee with such a title). Regardless, the individual who acts in this capacity has a responsibility to hire individuals who display the traits and abilities the firm desires in its professional employees. Firms that embrace a quality initiative will seek to hire new employees that seem to demonstrate a commitment to quality.

DRAFTING QUALITY CONTROL POLICIES AND PROCEDURES

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 tool 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 for implementing the policies and procedures. After reviewing authoritative literature, this course recommends that the illustrative examples found in the AICPA Practice Aid for designing the leadership responsibilities for quality within the firm element of the quality control system be considered.

Exhibit 1-6 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 leadership responsibilities for quality within the firm quality control system. The example policies are in bold type, example procedures are in regular type, and potential suggested descriptions are in italics.

Exhibit 1-6

AICPA Illustrative Quality Control Policies and Procedures Related to Leadership Responsibilities for Quality Within the Firm (the *Tone at the Top*)

- 1. The firm documents its QC policies and procedures and communicates them to the firm's personnel. (See paragraph .18 of QC section 10.)**
 - The QC partner is responsible for documenting the firm's QC policies and procedures and keeping that documentation up-to-date (reviewing at least annually).
 - New hires are required to acknowledge receipt of the firm's QC document in writing, and that they have been informed that failure to adhere to the firm's policies and procedures or failure to demonstrate commitment to ethical principles may result in disciplinary action.
 - At least annually, firm personnel receive training on the firm's QC policies and procedures, and acknowledge receipt of the QC document. This training is provided through [select as appropriate: *an informal discussion; an in-house training session; in-house training sessions with a web-based or video-based discussion of QC*] to ensure all personnel hear the message the same way.
 - Training on the firm's QC policies and procedures includes the following:
 - A review of changes during the year.
 - A "refresh" of the understanding of experienced employees and partners.
 - A discussion of the "why" behind policies and procedures. Those responsible for QC matters are always prepared to demonstrate, explain, or make the case for why a requirement is in place (that is, what benefit it serves).
 - "Tests" on the QC document to determine which part of the policy is misunderstood or not well-known.
- 2. The firm's policy is to promote an internal culture that recognizes that quality is essential in performing engagements. (See paragraph .19 of QC section 10.)**
 - The firm promotes an internal culture that recognizes quality is essential through [*describe the firm's specific action. For example, a mission statement that includes the firm's core values and the importance*

of quality; frequent messages to personnel about the importance of quality and that it is not sacrificed to the need to achieve profitability; the status of the QC partner within the firm (that is, the QC function is not relegated to an administrative role); the QC partner reports directly to the owners; and quality is considered in performance appraisals and compensation.]

3. **The firm's leadership assumes ultimate responsibility for the firm's system of quality control. (See paragraph .19 of QC section 10.)**
 - The managing partner, [Name], accepts ultimate responsibility for the firm's system of quality control and for setting a tone that emphasizes the importance of quality and of following the firm's system of quality control.
 - The managing partner acknowledges this responsibility, and the importance of quality, through [a written] communication to firm personnel at least once a year.
4. **The firm does not allow commercial considerations to override the quality of the work performed, and assigns management responsibilities accordingly.**
 - The managing partner and each engagement partner evaluate client relationships and specific engagements so that commercial considerations do not override the objectives of the system of quality control.
 - The firm emphasizes to all personnel that fee considerations and scope of services should not infringe upon quality work.
 - The firm considers the costs associated with a strong system of quality control, such as the costs of maintaining necessary competency, practice aids, and professional subscriptions, hiring consultants and engagement quality control reviewers, as an investment and factors them in when determining rates and fees so that commercial considerations will not override the quality of work performed.
5. **Personnel with sufficient and appropriate experience, authority and ability are assigned responsibility for developing, implementing and operating the firm's quality control system. (See paragraph .20 of QC section 10.)**
 - [Name of partner or director] is designated as the QC partner and has overall responsibility for developing and implementing appropriate policies and procedures for the firm's quality control system.
 - The firm's QC partner has the following characteristics:
 - Sufficient and appropriate experience and competency to serve in that capacity.
 - Up-to-date industry-specific CPE credits in any high-risk areas they review.
6. **The firm devotes sufficient and appropriate resources for the development, communication, and support of its quality control policies and procedures.**
 - The firm provides the designated quality control partner with sufficient time, authority, and resources to develop, implement, and maintain the firm's quality control policies and procedures.
 - The firm obtains feedback from personnel, such as the method for personnel to propose new or revised policies and procedures.
7. **Performance evaluation, compensation, and advancement (including incentive systems) with regard to personnel demonstrate the firm's overarching commitment to the objectives of the system of quality control.**
 - Performance evaluation and advancement systems are designed and implemented that reward partners and staff involved in the accounting and auditing practice for the quality of their work and their compliance with professional standards.

- The firm's compensation system provides incentives to accounting and auditing partners and senior-level employees for the quality of their accounting and auditing work. The compensation system does the following:
 - Takes into consideration firm feedback based on monitoring results and peer reviews of the work performed.
 - Rewards partners and personnel for timely (a) identification of significant and emerging accounting and auditing issues and (b) consultation with firm experts.
-

While the AICPA's illustrative policies and procedures provide a logical starting point for designing the leadership responsibilities for quality within the firm QC system, firms should carefully consider their needs before adopting them. 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 illustrative policies and procedures will be applicable to every firm. A firm's documented quality control system needs to be tailored for the policies and procedures that are appropriate for the particular firm.

Peer Reviewers Evaluate QC System Design. During the planning phase of a firm's peer review, the peer reviewer completes a questionnaire to evaluate the design of the firm's quality control policies and procedures. The questionnaire concentrates on the QC 10 requirements for each element of quality control, but also considers the related application guidance. Reviewers consider if a firm's documented quality control policies and procedures do not address the guidance in QC 10 because such a situation may indicate that the firm's system of quality control could be out of compliance with professional standards. Firms may access those same questionnaires in the AICPA *Peer Review Program Manual* (PRPM) (section 4600 of the PRPM presents the questionnaire for firms with two or more personnel, and section 4500 of the PRPM presents the questionnaire for a sole practitioner with no personnel). This course recommends that practitioners involved in designing and maintaining the firm's QC system read the 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 also available on the AICPA's Enhancing Audit Quality Initiative resources web page at us.aicpa.org/interestareas/privatecompaniespracticesection/qualityservicesdelivery/keepingup/invigorate-the-focus, beneath the "Quality Control & Peer Review" heading. Access to the questionnaires is restricted to AICPA members.

Developing Leadership 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 size of the firm, the number of firm locations, operating characteristics of the firm, the knowledge and experience of firm personnel, and the nature and complexity of the firm's practice, including whether it is part of a network, can impact the QC policies and procedures for a given firm.

There is more than one way to develop a firm's quality control policies and procedures. For example, this course chooses to develop one policy statement for each QC element and then design 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, along 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.

EVALUATION OF THE OVERALL ADEQUACY OF THE QC SYSTEM'S DESIGN

Understanding the leadership responsibilities for quality QC element may be more challenging than understanding the other five QC elements because it is the least tangible element. Additionally, the AICPA has suggested that this QC element is the most significant because a firm with deficient quality-oriented leadership and lack of proper tone at the top often struggles with maintaining an effective and successful system of quality control.

Consider the following situation: A firm's quality control document indicates that the firm owners are responsible for the firm's system of quality control. However, because the firm owners do not consistently promote a culture of quality within the firm, during the firm's most recent peer review a significant number of Matters for Further Consideration (MFCs) were identified. Those MFCs included—

- Lack of adherence to the firm's quality control policies and procedures, which resulted in missing audit programs.
- Incomplete disclosures.
- Inadequate monitoring of engagement performance.
- Reports issued that did not conform with the requirements of professional standards.

Due to the pervasive and significant MFCs, this firm will likely receive a *fail* peer review report. However, any of the above MFCs individually, while significant, may not result in a *fail* peer review report. For example, a firm not using a disclosure checklist to ensure the completeness of financial statement disclosures, but otherwise consistently following appropriate professional standards and the firm's system of quality control, would probably receive a *pass* or a *pass with deficiencies* peer review report.

The types of matters that result in MFCs relating to leadership responsibility for quality (*tone at the top*) might often appear to be related to engagement performance issues. For example, most of the MFCs listed above are related to engagement performance procedures. The difference between an engagement performance matter and a tone at the top matter is generally the pervasiveness and the breadth of the situation. By uncovering the systemic cause of a firm's peer review deficiencies, it becomes easier to make the determination of whether the issues identified are the result of management (leadership) actions. For example, personnel may not be performing appropriate procedures due to firm partners not allowing enough time to do so because firm leadership prioritizes engagement realization higher than engagement quality. As another example, personnel may not be performing appropriate procedures due to a lack of adequate training because firm leadership seeks to minimize nonchargeable staff time in order to be more profitable. When a firm has a blatant disregard for promoting quality in the firm, or the firm prioritizes profitability over engagement quality, a tone at the top problem is indicated.

The ideas, recommendations, and suggestions in this course relating to leadership responsibilities for quality within the firm 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, of course, lies with the firm. To help determine whether the leadership responsibilities for quality within the firm policies and procedures meet the firm's needs and provide reasonable assurance that the firm is in compliance with the quality control standards, practice aids, such as the ones provided in *PPC's Guide to Quality Control*, may be used. Those practice aids provide a summary of what the quality control policies and procedures for each quality control element need to address. Reviewing the questions in the leadership responsibilities for quality within the firm section of the appropriate practice aid will be useful in performing a final assessment of the firm's quality control policies and procedures for this QC element.

Additionally, the firm may wish to consider examples of matters noted in recent peer reviews relating to leadership responsibilities for quality. Exhibit 1-7 provides such information.

Exhibit 1-7

Leadership Responsibilities for Quality—Matters Noted in Peer Reviews

- Failure to have a written quality control document in accordance with QC 10.
 - Failure to communicate quality control policies and procedures with staff.
 - Failure to update the engagement quality control review (EQCR) and monitoring QC policies and procedures as needed.
 - Failure to devote sufficient resources for the support of its quality control policies and procedures.
-

MONITORING LEADERSHIP COMPLIANCE WITH THE FIRM'S POLICIES AND PROCEDURES

The firm should review, on an ongoing basis, its leadership responsibilities for quality within the firm's 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 leadership responsibilities for quality within 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.

4. What guidance does AT-C 105 provide specifically related to the quality of attestation engagements?
 - a. It requires the engagement partner to ensure quality on each attestation engagement.
 - b. It requires engagement teams to take responsibility for implementing appropriate quality control procedures.
 - c. It requires engagement partners to comply with the firm's quality control procedures.
 - d. It requires firms to integrate their quality control objectives into the organizational documents.
5. A successful quality control director needs to be which of the following?
 - a. An objective third party.
 - b. A new member of the firm.
 - c. Technically proficient in taxation.
 - d. Personally committed to quality.
6. Which of the following is an example of a quality control policy from the AICPA Practice Aid related to leadership responsibilities for quality within the firm?
 - a. The managing partner acknowledges this responsibility, and the importance of quality, through a written communication to firm personnel at least once a year.
 - b. The firm documents its quality control policies and procedures and communicates them to the firm's personnel.
 - c. The firm emphasizes to all personnel that fee considerations and scope services should not infringe upon quality work.
 - d. The firm requests personnel feedback on the best method for proposing new QC policies and procedures.

SELF-STUDY ANSWERS

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

4. What guidance does AT-C 105 provide specifically related to the quality of attestation engagements? **(Page 19)**
- a. **It requires the engagement partner to ensure quality on each attestation engagement. [This answer is correct. AT-C 105.35 stipulates an overarching requirement for leadership quality by assigning the responsibility to the engagement partner to ensure quality on each attestation engagement. The overarching requirement is followed with a list of specific quality-related tasks that the engagement partner is expected to be responsible for, including the acceptance and continuance decision and certain engagement performance procedures.]**
 - b. It requires engagement teams to take responsibility for implementing appropriate quality control procedures. [This answer is incorrect. AR-C 60.A40 (not AT-C 105) stresses that, for SSARS engagements, the engagement teams have a responsibility to implement quality control procedures that are appropriate to the engagement.]
 - c. It requires engagement partners to comply with the firm's quality control procedures. [This answer is incorrect. AU-C 220.A3, which pertains to audit engagements, not AT-C 105, explains that, in demonstrating the responsibility for the overall quality on each audit engagement, the engagement partner's actions and messages sent to other members of the engagement team can emphasize the importance to audit quality of, among other things, complying with the firm's quality control policies and procedures.]
 - d. It requires firms to integrate their quality control objectives into the organizational documents. [This answer is incorrect. Integrating the quality objective in the firm's organizational documents is one way that a firm can show its commitment to quality in its business strategy. However, this is not a requirement specifically laid out by AT-C 105 for attestation engagements.]
5. A successful quality control director needs to be which of the following? **(Page 21)**
- a. An objective third party. [This answer is incorrect. It is important that the quality control director be intimately familiar with the firm and how it operates, including having a fairly thorough understanding of the firm's partners, staff, clients, and the nature of the firm's practice. Someone outside the firm would be less likely to have a good enough understanding.]
 - b. A new member of the firm. [This answer is incorrect. Ideally, the quality control director should be recognized throughout the firm as a leader who gets things accomplished. A new member of the firm would not have had time to build up a track record of accomplishments to earn such a reputation.]
 - c. Technically proficient in taxation. [This answer is incorrect. To be a successful quality control director, technical proficiency is needed in accounting, quality control, peer review, and other professional standards. Someone lacking such proficiency would almost certainly be consigned to failure, and such a choice would also cause the commitment of the firm to the project to be called into question by partners and staff. However, the proficiency should be in the areas covered by the quality control system, which is the firm's accounting and auditing practice.]
 - d. **Personally committed to quality. [This answer is correct. The quality control director needs to believe in the importance of the development of a quality control system for the firm. If the individual does not believe in the project, it is unlikely that they will be able to lead the firm through the process.]**

6. Which of the following is an example of a quality control policy from the AICPA Practice Aid related to leadership responsibilities for quality within the firm? **(Page 22)**
- a. The managing partner acknowledges this responsibility, and the importance of quality, through a written communication to firm personnel at least once a year. [This answer is incorrect. This is an example of a specific procedure that may be implemented to fulfill one of the firm's policies.]
 - b. **The firm documents its quality control policies and procedures and communicates them to the firm's personnel. [This answer is correct. Per paragraph .18 of QC section 10, this is an example of a quality control policy from the AICPA Practice Aid. One example procedure that could be adopted to support this policy is, "The QC partner is responsible for documenting the firm's QC policies and procedures and keeping that documentation up-to-date (reviewing at least annually)."]**
 - c. The firm emphasizes to all personnel that fee considerations and scope services should not infringe upon quality work. [This answer is incorrect. Per the AICPA Practice Aid, this is an example of a procedure which might be created to support a policy such as, "The firm does not allow commercial considerations to override the quality of the work performed, and assigns management responsibilities accordingly."]
 - d. The firm requests personnel feedback on the best method for proposing new QC policies and procedures. [This answer is incorrect. This is an example of a procedure, which could support a policy such as, "The firm devotes sufficient and appropriate resources for the development, communication, and support of its quality control policies and procedures."]

Lesson 2: Engagement Performance

INTRODUCTION

The primary goal of establishing engagement performance policies and procedures is to design a standardized engagement approach that provides reasonable assurance that engagements are consistently performed and conform to professional standards and applicable legal and regulatory requirements. A standardized engagement approach is not intended to be a substitute for the exercise of professional judgment. An engagement performance QC system encompasses the unique planning, performing, supervising, reviewing, documenting, and communicating decisions that occur on each engagement. There is no differentiation of service level in SQCS No. 8, *A Firm's System of Quality Control* (QC 10), regarding the requirements for engagement quality control review, documentation, consultation, and resolution of differences, so those requirements are relevant for SSARS engagements as well as audit and attestation engagements. Accordingly, the engagement performance quality control system needs to be flexible enough to address all of those different types of engagements.

Learning Objectives:

Completion of this lesson will enable you to:

- Identify the quality control requirements for engagement performance, supervision, and review.
- Determine how a firm should address consultations, differences of opinion, engagement quality control review, and engagement documentation.
- Identify appropriate strategies for drafting the firm's quality control policies and procedures and evaluating the overall adequacy of the design of the quality control system.

Authoritative Literature

QC 10 includes guidance on engagement performance, supervision and review responsibilities, consultation, engagement quality control review, differences of opinion, and engagement documentation, all as part of the engagement performance element. Additionally, the auditing, attestation, and SSARS 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 similar guidance, but specific to the performance of audit engagements, generally focusing on the responsibilities of the audit partner and engagement team. AT-C 105, *Concepts Common 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 engagement-level quality control requirements for the engagement partner's responsibilities when performing an engagement under the SSARS.

The engagement performance QC element also relies on appropriate adherence to the authoritative literature that addresses the performance of audit, attestation, review, compilation, and financial statement preparation engagements. Thus, the SAs, SSAEs, and SSARS, as well as the AICPA *Code of Professional Conduct* (the Code), can all be considered integral parts of the engagement performance QC element.

Requirements

The engagement performance QC element contains more requirements than any of the other individual elements of the QC system. Those requirements are discussed in detail in this lesson.

Summary of This Lesson

This lesson is organized as follows:

- a. The authoritative requirements that address the engagement performance element of a firm's system of quality control.

- b. The engagement performance element includes consultation when appropriate and dealing with differences of opinion. This lesson addresses how firms may meet these requirements.
- c. Information about the quality control requirement for engagement quality control review, including establishing the firm's unique criteria for engagement quality control review, establishing qualification for appointment and replacement of engagement quality control reviewers, and performing and documenting engagement quality control reviews.
- d. Assembly, retention, and other engagement documentation requirements.
- e. Useful instruction for how a firm may draft its engagement performance quality control policies and procedures.
- f. Why and how a firm evaluates the overall adequacy of the design of the engagement performance component of its quality control system.
- g. Monitoring the operating effectiveness of the firm's quality control system, one of the requirements of QC 10, is briefly discussed.

REQUIREMENTS FOR ENGAGEMENT PERFORMANCE, SUPERVISION, AND REVIEW

Due to its complexity, designing the engagement performance element of a QC system may be the most difficult aspect of preparing a QC document. For example, engagement performance covers all types of accounting and auditing engagements and needs to interface with the accounting and auditing materials used by the firm. Additionally, engagement performance considers the policies and procedures found in other QC elements. To be most effective, the firm will want to design the engagement performance component of its quality control system based upon the size of the firm and the nature of the firm's engagements. The difficulty of designing appropriate engagement performance policies and procedures is supported by the knowledge that the majority of peer review matters relate to engagement performance.

Being familiar with the quality control requirements for engagement performance, review, and supervision is necessary to understand the overall intent of the engagement performance policies and procedures. The general engagement performance requirements under QC 10 are presented in Exhibit 2-1. Further, the general requirements under AU-C 220 that direct engagement performance and review for audit engagements are presented in Exhibit 2-2; the engagement-level QC requirements under AT-C 105 that oversee attestation engagement performance are presented in Exhibit 2-3; and the engagement-level QC requirements under AR-C 60 that direct engagement performance for SSARS engagements are presented in Exhibit 2-4.

Exhibit 2-1

General Requirements for Engagement Performance QC Policies and Procedures under QC 10

Requirements	QC 10
The firm should establish policies and procedures to provide reasonable assurance that engagements are performed in accordance with professional standards, as well as applicable legal and regulatory requirements, and that the firm issues reports that are appropriate in the circumstances. Such policies and procedures should promote consistency in the quality of engagement performance and address supervision and review responsibilities.	QC 10.35
The firm's policies and procedures for review responsibilities should be determined on the basis that suitably experienced engagement team members, which may include the engagement partner, review work performed by other engagement team members.	QC 10.36

Exhibit 2-2**General Requirements for Audit Engagement Performance QC Procedures under AU-C 220**

Requirements	AU-C 220
The engagement partner should take responsibility for the direction, supervision, and performance of the audit engagement. The engagement partner is charged with ensuring that (1) professional standards, applicable legal and regulatory requirements, and firm policies and procedures are followed, and (2) the auditor's report is appropriate in the circumstances.	AU-C 220.17
The engagement partner should ensure that reviews are being performed in accordance with the firm's review policies and procedures.	AU-C 220.18
Based on the review of audit documentation and discussion with the engagement team, the engagement partner, on or before the date of the auditor's report, should be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued.	AU-C 220.19

Exhibit 2-3**Attestation Engagement-level QC Requirements under AT-C 105**

Requirements	AT-C 105
The engagement partner should take responsibility for the planning and performance of the attestation engagement, including providing appropriate direction and overseeing the supervision of the engagement, to ensure that professional standards and applicable legal and regulatory requirements are satisfied.	AT-C 105.35(b)
The engagement partner should ensure that reviews are being performed in accordance with the firm's review policies and procedures, and the engagement documentation is reviewed on or before the date of the practitioner's report.	AT-C 105.35(c)

Exhibit 2-4**SSARS Engagement-level QC Requirements under AR-C 60**

Requirements	AR-C 60
The engagement partner should take responsibility for the direction, supervision, planning, and performance of the engagement in compliance with professional standards and applicable legal and regulatory requirements.	AR-C 60.21(b)
The engagement partner should take responsibility for the accountant's report to be appropriate in the circumstances.	AR-C 60.21(c)

Before beginning the process of designing engagement performance, supervision, and review policies and procedures that fit the firm's practice, it is necessary to also become familiar with the authoritative guidance under which engagements are conducted. A review of accounting, auditing, attestation, and ethics literature is appropriate to determine if there are particular requirements that need to be considered during the design and execution of the

engagement performance quality control element. The AICPA and its senior technical bodies such as the Auditing Standards Board (ASB), the Accounting Review and Services Committee (ARSC), and the Professional Ethics Executive Committee (PEEC) issue most of the authoritative guidance under which CPAs perform engagements. That authoritative guidance can generally be found in the Statements on Quality Control Standards (SQCSs), *Code of Professional Conduct*, Statements on Standards for Accounting and Review Services (SSARS), Statements on Auditing Standards (SASs), and Statements on Standards for Attestation Engagements (SSAEs). The requirements that affect engagement performance, supervision, and review are discussed in the remainder of this section.

QC 10 Requirements

When firms plan and perform engagements, the appropriate relevant professional standards should be followed. For example, when planning and performing audit engagements, the firm should adhere to the guidance in the auditing standards. QC 10.35 requires firms to establish policies and procedures designed to provide reasonable assurance that the firm's engagements are consistently performed and follow the appropriate relevant professional standards and comply with applicable legal and regulatory requirements. Those policies and procedures should also provide reasonable assurance that the firm issues reports that are appropriate given the circumstances of the specific engagement. In the context of QC 10, *reasonable assurance* means a high, but not absolute, level of assurance.

QC 10.35 also requires that effective policies and procedures facilitate consistency in the quality of engagement performance. QC 10.A32 further explains that achieving consistency may be accomplished by using written or electronic manuals, software tools, or other forms of standardized documentation, as well as industry-specific or other subject-matter-specific guidance materials. Examples of processes the firm may address include—

- How engagement teams are briefed to obtain an understanding of the objectives of their work.
- Processes for complying with applicable engagement standards.
- Processes for engagement supervision, staff training, and mentoring.
- Methods of reviewing work performed, significant judgments made, and the form of report being issued.
- Appropriate documentation of the work performed, and the timing and extent of the review.
- Processes to keep policies and procedures current.

QC 10.A33 indicates that consistency in the quality of engagement performance can be promoted through appropriate teamwork and by training less experienced engagement team members to clearly understand the objectives of their assigned work.

QC 10.36 requires that suitably experienced engagement team members review the work performed by other engagement team members. Generally, a suitably experienced engagement team member would be a team member with more experience than the engagement team member who performed the work.

QC 10.A34 provides guidance regarding supervision responsibilities and indicates that engagement supervision includes the following:

- Tracking engagement progress.
- Considering the competence and capabilities of individual engagement team members, whether they have sufficient time to perform their work, whether they understand their instructions, and whether their work is carried out in accordance with the planned engagement approach.
- Addressing significant findings and issues that arise during the engagement, considering their significance, and modifying the planned approach as appropriate.
- Identifying matters for consultation or consideration by engagement team members with more experience.

QC 10.A35 suggests that reviewing an engagement considers whether—

- The work is performed in accordance with professional standards and applicable legal and regulatory requirements.
- Significant findings and issues are raised for further consideration.
- Appropriate consultations take place and resulting conclusions are documented and implemented.
- The nature, timing, and extent of work performed is appropriate and without need for revision.
- The procedures performed support the conclusions reached and are properly documented.
- Evidence obtained is sufficient and appropriate to support the report.
- The objectives of the procedures performed are achieved.

Ethical Requirements

Ethical requirements over CPA engagement performance and behavior are set out in the Code. Many state licensing organizations require compliance with the ethical standards issued by the AICPA, even for CPAs who are not AICPA members. Six principles describe the general conduct required by CPAs:

- Responsibilities
- The Public Interest
- Integrity
- Objectivity and Independence
- Due Care
- Scope and Nature of Services

The principles can be found at ET 0.300. QC 10 refers to them as the fundamental principles of professional ethics. The Code also includes rules and interpretations. Members who depart from those guidelines must justify such departure in any disciplinary hearing.

Performing nonattest services for attest clients may result in independence impairment if the related ethical requirements are not followed. The independence interpretation, *Nonattest Services* (ET 1.295), indicates that, before practitioners perform nonattest services for attest clients, they should determine that the requirements of the *Nonattest Services* interpretation have been met. One of those requirements (ET 1.295.040.01) states that practitioners should document in writing their understanding with the client regarding the nonattest services and the client's responsibilities. That understanding should include (a) the objectives of the nonattest services, (b) the services to be performed, (c) the client's acceptance of its responsibilities, (d) the practitioner's responsibilities, and (e) any limitations of the engagement. The documentation requirement creates an engagement performance step that should be included in a firm's quality control policies and procedures.

Additionally, when providing nonattest services to an attest client, the practitioner is required to—

- be satisfied that, among other things, the client agrees to assume all management responsibilities pertaining to the nonattest service and oversee the service by designating an individual who possesses suitable skill, knowledge, and/or experience;
- assess and be satisfied that the designated individual understands the services to be performed sufficient to oversee them; and
- consider whether the performance of multiple nonattest services to the client creates a threat to independence.

Adhering to the ethical requirements when providing nonattest services for attest clients is scrutinized during a firm's peer review. The Engagement Profile forms required to be completed for each engagement selected for peer review ask for detailed information relating to providing nonattest services to attest clients, including—

- Identification of the individual in the firm responsible for assessing the specific nonattest service.
- Name and title of client personnel designated to oversee the nonattest service.
- Description of the firm's assessment and factors leading to the firm's satisfaction that client personnel possessed sufficient skills, knowledge, and experience to oversee the nonattest service.

Audit Requirements

Engagement performance requirements for audit engagements are located in the *Statements on Auditing Standards* (SASs) promulgated by the AICPA's Auditing Standards Board (ASB). The auditing standards use "AU-C" section numbers, organized as follows:

- AU-C Section 200–299: *General Principles and Responsibilities*.
- AU-C Section 300–499: *Risk Assessment and Response to Assessed Risks*.
- AU-C Section 500–599: *Audit Evidence*.
- AU-C Section 600–699: *Using the Work of Others*.
- AU-C Section 700–799: *Audit Conclusions and Reporting*.
- AU-C Section 800–899: *Special Considerations*.
- AU-C Section 900–999: *Special Considerations in the United States*.

PPC's *Guide to Audits of Nonpublic Companies* provides detailed guidance and a full complement of practice aids for adhering to the engagement performance requirements of the SASs. Many firms use a *bridging document* to summarize the procedures to be performed in every audit, interfacing the bridging document with the firm's QC document. Use of a bridging document is further discussed later in this lesson.

AU-C 220. As previously mentioned, AU-C 220 includes performance and documentation responsibilities for auditors regarding quality control procedures at the engagement level. AU-C 220.17 indicates that the engagement partner should take responsibility for the direction, supervision, and performance of the audit engagement. The engagement partner is charged with ensuring that (a) professional standards and applicable legal and regulatory requirements and the firm's policies and procedures are followed and (b) the auditor's report is appropriate in the circumstances.

AU-C 220.18 requires the engagement partner to take responsibility for review of the work performed in accordance with the firm's review policies and procedures. AU-C 220.19 indicates that, based on the review of audit documentation and discussion with the engagement team, on or before the date of the auditor's report, the engagement partner should be satisfied that sufficient appropriate audit evidence has been gathered to support the conclusions reached and the auditor's report to be issued.

AU-C 220.A12 provides guidance to assist engagement partners in understanding how to fulfill those requirements. As the engagement partner directs the audit engagement, he or she informs the members of the engagement team about matters such as the following:

- Their responsibilities.
- The responsibilities of respective partners when multiple partners are involved in conducting the engagement.
- The objectives of the work to be performed.
- The nature of the entity's business.

- Risk-related issues.
- Problems that may arise.
- The detailed approach to the performance of the engagement.

Responsibilities of the engagement team include planning and performing the audit with an appropriate level of professional skepticism, and performing the work assigned to them in accordance with relevant ethical requirements. Discussion among the engagement team facilitates team member questions so that appropriate communication can take place within the engagement team.

An engagement team performs most effectively by using appropriate teamwork and training to assist all team members to clearly understand the objectives of the work assigned to them.

AU-C 220.A14 provides guidance regarding the supervision responsibilities of the audit engagement partner. Those responsibilities are the same as the engagement supervision responsibilities provided by QC 10. Similarly, the engagement review considerations provided at AU-C 220.A16 mirror the engagement review considerations in QC 10.

AU-C 220.A17 further explains that the engagement partner's review of work performed includes timely reviews at appropriate stages of the engagement. Timely review allows significant matters to be promptly resolved to the engagement partner's satisfaction on or before the date of the auditor's report. Reviewing audit documentation relating to the following facilitates achieving such satisfaction:

- Critical areas of judgment, especially relating to difficult or contentious matters.
- Significant risks.
- Other areas deemed important by the engagement partner.

The engagement partner may choose to review all audit documentation but is not required to do so. As previously mentioned with regard to QC 10 and included in AU-C 220, the engagement partner may delegate part of the review responsibility to other members of the engagement team in accordance with the firm's system of quality control. A record of who reviewed the audit work performed and the date and extent of such review is required by AU-C 230, *Audit Documentation*, at AU-C 230.09. AU-C 230.A15 further explains that this requirement does not imply that every specific workpaper has to include such evidence of review. However, the requirement means documenting what audit work was reviewed, who reviewed such work, and when it was reviewed.

Sometimes the engagement partner on an audit is unable to continue performing in that role through completion of the engagement. When such a situation occurs, a replacement engagement partner is assigned after the engagement has already started. To assume the responsibilities of the engagement partner, he or she applies the review procedures discussed in the previous paragraph to review the work that has been performed up to the point at which he or she became the engagement partner.

When an engagement team includes a member with specialized expertise in an area of accounting or auditing, supervision and review of that engagement team member's work is the same as for any other engagement team member. The use of an engagement member with specialized expertise also may necessitate agreement between that individual and the engagement partner regarding (a) the nature, scope and objectives of that individual's work and the respective roles of each member of the engagement team; and (b) the nature, timing, and extent of communication between that individual and other members of the engagement team. Additionally, the engagement partner evaluates the adequacy of that individual's work, including their findings or conclusions and whether those findings or conclusions are consistent with other audit evidence obtained.

Audit Documentation Requirements. Documentation is an important aspect of engagement performance. AU-C 230 provides the documentation requirements that auditors should follow when performing an audit engagement. It requires the auditor to prepare and retain workpapers; addresses the form, content, and extent of audit documentation; and specifies requirements for revisions made to documentation after the date of the auditor's report. Auditors are expected to comply with those requirements, but in the rare circumstance that an auditor judges it necessary to

depart from a documentation requirement, AU-C 230.13 indicates that the auditor must document the justification for a departure from a relevant presumptively mandatory requirement and how alternative procedures performed were sufficient to achieve the intent of the requirement. AU-C 230 explains the nature and purposes of audit documentation, stating that audit documentation provides evidence (a) of the auditor's basis for the conclusion regarding the achievement of the overall audit objectives, and (b) that the audit was planned and performed in accordance with GAAS and applicable legal and regulatory requirements. Obviously, audit documentation is an integral component of engagement performance.

Additionally, AU-C 230.03 lists other purposes for audit documentation, including—

- Assisting the engagement team with planning and performing the audit.
- Assisting auditors to understand the work performed in the prior year as an aid in planning and performing the current engagement.
- Assisting members of the engagement team responsible for supervision to direct and supervise the audit work and to review the quality of work performed, in accordance with AU-C 220.
- Demonstrating the accountability of the audit team for its work by documenting the procedures performed, the audit evidence examined, and the conclusions reached.
- Retaining a record of matters of continuing significance to future audits of the same entity.
- Enabling the performance of quality control reviews and inspections in accordance with QC 10.
- Enabling the conduct of peer reviews or other external inspections in accordance with applicable legal, regulatory, or other requirements.
- Assisting an auditor who reviews a predecessor auditor's audit documentation.

AU-C 230.07–.19 detail the general requirements for documenting audit engagement performance. Other AU-C sections include additional documentation requirements that specify the application of AU-C 230 in the particular circumstances of those other AU-C sections. (AU-C 230.A30 provides a listing of audit documentation requirements located in other AU-C sections.)

Emphasis on Audit Documentation. Audit documentation is one of the areas of focus emphasized by the AICPA through its Enhancing Audit Quality initiative. *Emphasis has also been placed on audit documentation in the area of peer review, where the AICPA has instructed peer reviewers to treat audit procedures not documented as not performed.* To help firms better understand and comply with audit documentation requirements, the AICPA provides free audit documentation resources and tools to firms. For example, one of the tools provided is a PowerPoint presentation designed to support firms as they train audit personnel on how to comply with AU-C 230. Those resources and tools are available on the AICPA's website at us.aicpa.org/eaq/peer-review-documentation-resources.html.

Emphasis on Audit Risk Assessment and Internal Control. In 2018, peer reviewers began noting deficiencies in the area of risk assessment in a significant percentage of audits. Additional information and various risk-assessment-related resources are available at us.aicpa.org/eaq/aicpa-risk-assessment-resources.html. In that same year, an AICPA Peer Review Program survey showed that over 40% of nonconforming audit engagements did not comply with professional standards due to a failure to obtain an understanding of internal control when identifying the risks of material misstatement. Several resources to help comply with requirements related to internal controls are available at us.aicpa.org/eaq/internal-control-resources.html.

Emphasis on COVID-19 and Revenue Recognition. In 2020, the AICPA added resources to its Enhancing Audit Quality webpage to help firms understand and manage new challenges as they perform audits in a COVID-19 environment. The resources address considerations for remote auditing, and various other aspects of performing an audit that have been affected by the COVID-19 environment. (COVID-19 considerations are further discussed later in this section.) Also in 2020, the AICPA added resources to its Enhancing Audit Quality webpage to help firms with auditing revenue recognition (FASB ASC 606), one of the most significant changes to the accounting standards in many years. Those resources are accessible from us.aicpa.org/eaq.html.

Attestation Requirements

The definition of an *accounting and auditing practice* for quality control purposes also includes engagements performed under the Statements on Standards for Attestation Engagements. Accordingly, firms that perform attestation engagements should include policies and procedures that address such engagements in the design of their QC systems. The attestation standards use “AT-C” section numbers organized into three major sections as follows:

- AT-C 105, *Concepts Common to All Attestation Engagements*, including engagement-level QC requirements. Overview information on the engagement-level QC requirements is provided below.
- Guidance for each of the levels of service: examinations (AT-C 205 and AT-C 206), reviews (AT-C 210), and agreed-upon procedures (AT-C 215).
- Guidance for specific types of subject matter: examinations and agreed-upon procedures for prospective financial information (AT-C 305); examinations and reviews of pro forma financial information (AT-C 310); examinations and agreed-upon procedures of compliance with laws, regulations, or contracts (AT-C 315); examinations of internal control at service organizations (AT-C 320); and examinations and reviews of management's discussion and analysis (AT-C 395).

PPC's Guide to Nontraditional Engagements provides detailed guidance and practice aids for adhering to the engagement performance requirements of the attestation standards. Many firms use a *bridging document* to summarize the procedures to be performed in attestation engagements, interfacing the bridging document with the firm's QC document. Bridging documents are further discussed later in this lesson.

Engagement-level QC Responsibilities. Practitioners providing attestation services should follow both the general performance requirements of AT-C 105 and other specific performance requirements under the relevant type of service and/or subject matter guidance of the other AT-C sections. The engagement-level QC requirements of AT-C 105 charge the engagement partner with the responsibility for the overall quality on each attestation engagement, including engagement performance and documentation responsibilities. AT-C 105.35(b) indicates that the engagement partner should take responsibility for planning and performing the attestation engagement. The engagement partner is charged with ensuring that professional standards and applicable legal and regulatory requirements are followed.

AT-C 105.35(c) requires the engagement partner to take responsibility for review of the work performed in accordance with the firm's review policies and procedures. The engagement partner may choose to review all engagement work performed, but is not required to. According to AT-C 105.A64, the engagement partner may delegate part of the review responsibility to other members of the engagement team in accordance with the firm's system of quality control. Engagement documentation responsibilities are also discussed later in this lesson.

SSARS Requirements

The engagement performance requirements for review, compilation, and financial statement preparation engagements are located in the *Statements on Standards for Accounting and Review Services* (SSARS) promulgated by the AICPA's Accounting and Review Services Committee (ARSC). The SSARS use “AR-C” section numbers, organized as follows:

- AR-C Section 60: *General Principles for Engagements Performed in Accordance with Statements on Standards for Accounting and Review Services*.
- AR-C Section 70: *Preparation of Financial Statements*.
- AR-C Section 80: *Compilation Engagements*.
- AR-C Section 90: *Review of Financial Statements*.
- AR-C Section 100: *Special Considerations—International Reporting Issues*.
- AR-C Section 120: *Compilation of Pro Forma Financial Information*.

Overview information on the engagement-level QC responsibilities of AR-C 60 is provided below. *PPC's Guide to Compilation and Review Engagements* and *PPC's Guide to SSARS Preparation Engagements* provide detailed guidance and a full complement of practice aids for adhering to the engagement performance requirements of the SSARS. Many firms use a *bridging document* to summarize the procedures to be performed in SSARS engagements, interfacing the bridging document with the firm's QC document.

Engagement-level QC Responsibilities. Accountants performing SSARS engagements should follow both the general principles of AR-C 60 and the other specific performance requirements under the relevant type of service: preparation of financial statements (AR-C 70), compilation (AR-C 80), or review (AR-C 90). AR-C 60 provides engagement-level quality control requirements for the engagement partner when performing an engagement. The engagement-level quality control requirements of AR-C 60 include several of the elements found in QC 10, one of which is engagement performance.

The engagement partner's responsibilities in a SSARS engagement related to engagement performance are specifically addressed in AR-C 60.21. According to AR-C 60.21(b), the engagement partner is responsible for directing, supervising, planning, and performing the engagement to comply with all applicable professional standards and ethical and legal requirements. Additionally, AR-C 60.21(c) indicates that the engagement partner should assume the responsibility for the appropriateness of the accountant's report in the circumstances of the particular engagement. (AR-C 60.21 also addresses engagement-level quality control requirements for leadership, acceptance and continuance, and human resources.)

COVID-19 Considerations

The COVID-19 pandemic drastically changed many facets of the environment, affecting individuals, businesses, and governments. While the crisis mode of the pandemic environment has subsided now that the world has dealt with COVID-19 for more than two years, repercussions from the ongoing pandemic continue to create challenges and many businesses still struggle even though rebuilding efforts have occurred and are continuing. The significance of the repercussions from the pandemic continues to impact how firms need to satisfy engagement performance requirements. As previously mentioned, COVID-19 continues to alter most entities' operations, and thus, regardless of the type of engagement being performed, firms need to consider the COVID-19 implications as part of engagement planning and modify the engagement plan accordingly.

The AICPA has not released new standards to respond to issues arising from COVID-19. However, the AICPA and other organizations have provided extensive nonauthoritative COVID-19 resources providing advice on dealing with the engagement issues created. Thomson Reuters' PPC brand of accounting and auditing products includes a COVID-19 engagement considerations checklist in many of its 2021 and 2022 edition engagement-level products that provides a list of factors to consider related to the COVID-19 pandemic and understanding the entity and identifying risks.

Designing an Engagement Performance QC System

In designing an engagement performance QC system, firms ought to consider whether—

- It includes all types of accounting and auditing engagements performed by the firm.
- Procedures in other QC elements also relate to the engagement performance QC element.
- The engagement performance QC system—
 - interfaces with the firm's accounting and auditing materials, and
 - is appropriate for the size of the firm, considering the number of partners and staff, and difficulty level of the services provided by the firm.

Each of these points is further discussed below.

Cover All Types of Accounting and Auditing Engagements. Engagement performance policies and procedures should be developed for preparation, compilation, review, audit, and attestation engagements (to the extent the firm

provides or plans to provide those services). Accordingly, the engagement performance component of the quality control system needs to be flexible enough to address all types of engagements performed by the firm.

Consider Procedures Found in Other QC Elements. QC 10 is written as if each of the elements of quality control are distinctly separate, each with its own policies and procedures. In reality, however, several of the elements are interrelated and cannot be viewed in isolation. The engagement performance element deals with every aspect of an engagement from start to finish and thus encompasses many of the policies and procedures that are part of the other elements of quality control. Exhibit 2-5 helps to illustrate this point.

Exhibit 2-5

Relationship of Engagement Performance to Other QC Elements (Audit Engagements)

Leadership Responsibilities for Quality	Relevant Ethical Requirements	Acceptance and Continuance of Clients and Engagements	Human Resources	Engagement Performance	Monitoring	TYPICAL ENGAGEMENT PERFORMANCE QUALITY CONTROL STEPS
Yes	Yes	Yes	Yes	Yes		1. Evaluate whether to accept/continue the engagement, considering ethical requirements (including if nonattest services create an independence threat); the client's integrity; and the firm's competence, capabilities, time, and resources.
		Yes		Yes		2. Obtain a signed engagement letter.
Yes			Yes	Yes		3. Assign staff based on competence, capabilities, and availability.
				Yes		4. Develop a preliminary audit strategy, including consideration of more than one component, use of specialists, and/or service organizations.
				Yes		5. Determine and document planning materiality and performance materiality.
				Yes		6. Hold an engagement team discussion about the susceptibility of the financial statements to material misstatement due to error or fraud.
				Yes		7. Perform preliminary analytical procedures.
				Yes		8. Inquire of management and perform other risk identification and assessment procedures to obtain an understanding of the entity and its environment, including internal control.
				Yes		9. Identify and assess risks of material misstatement (including fraud risks) at the financial statement level and relevant assertion level and design responses to identified risks.
				Yes		10. Prepare an audit plan.
			Opt ^a	Opt ^a		11. Develop a time estimate.
	Yes		Yes	Yes		12. Obtain partner approval of audit plan and staff assignments, and, if applicable, time estimates.
				Opt ^a		13. Test, evaluate, and document design and operating effectiveness of internal control.
				Yes		14. Perform and document further audit procedures.
			Yes	Yes		15. Supervise procedures (including work of other auditors).
				Yes		16. Obtain legal representation letters.
				Yes		17. Summarize, evaluate, and conclude on the effect of accumulated misstatements.

Leadership Responsibilities for Quality	Relevant Ethical Requirements	Acceptance and Continuance of Clients and Engagements	Human Resources	Engagement Performance	Monitoring	TYPICAL ENGAGEMENT PERFORMANCE QUALITY CONTROL STEPS
				Yes		18. Perform final analytical review.
				Yes		19. Complete a presentation and disclosure checklist and read the financial statements.
				Yes		20. Obtain a management representation letter.
				N/A ^b		21.
Yes	Yes			Yes		22. Draft the report.
				Yes		23. Consider and document changes from the audit strategy, planning materiality, or audit plan.
Yes			Yes	Yes	Yes	24. Review the workpapers and determine and document the sufficiency and appropriateness of the audit evidence obtained.
				Yes		25. Determine that all review points and open items have been cleared.
Yes	Yes		Yes	Yes	Yes	26. Obtain an engagement quality control review, if required by firm policy.
Yes			Yes	Yes		27. Obtain consultation when appropriate and document and implement conclusions.
Yes			Yes	Yes		28. Resolve any differences of opinion and document and implement conclusions.
Yes	Yes	Yes	Yes	Yes	Yes	29. Determine that all quality control engagement-level procedures have been performed.
				Yes		30. Prepare required client communications.
Yes				Yes		31. Have the partner approve and sign the report or transmittal letter.
Yes			Yes	Yes		32. Evaluate the staff's performance.
	Yes			Yes		33. Maintain the confidentiality, safe custody, integrity, accessibility, and retrievability of the workpapers.
				Yes	Yes	34. Assemble and retain the workpapers for a sufficient period of time (subject to monitoring review).

Notes:

^a Opt—Optional.

^b This engagement performance step is reserved for a procedure performed during an audit of internal control over financial reporting, which is not performed in a regular audit. Accordingly, we have indicated N/A (not applicable) in the engagement performance column and have left the description of the step blank. See step 21 at Exhibit 2-17 for additional information.

The engagement performance system for audits in Exhibit 2-5 is typical of that used by local firms. Note that a number of the steps in this system are procedures found in one of the other elements of a QC system. For example, the relevant ethical requirements element of the quality control system may be viewed as an administrative system designed to monitor items such as client lists, employee relationships, past due receivables, and such. However, the relevant ethical requirements element also considers the engagement level by asking, "Is the firm independent with respect to this client?"

Likewise, an engagement acceptance and continuance QC system should contain overall policies and procedures about whether to accept a new client (or a new engagement) or to continue a relationship with an existing client. The system of acceptance and continuance procedures is also implemented at the engagement level as a part of the engagement performance system.

Interface the Engagement Performance System with the Firm's Accounting and Auditing Materials. Most firms have some type of engagement performance system, often comprised of accounting and auditing materials, including written guidance and practice aids (such as checklists, programs, confirmation letters, etc.) accumulated from various sources. The use of such materials helps ensure consistency in the quality of the firm's engagements. Many firms also adopt audit and accounting materials purchased from publishers or other firms. The engagement performance QC policies and procedures the firm adopts for its quality control system needs to be interfaced with those found in its materials, whether developed internally, purchased from a third party, or a combination of the two.

Consider Firm Size. Some engagement performance systems found in QC literature or in accounting and auditing materials may be designed for large firms that need complex systems because of their practice size. Alternatively, some engagement performance materials may be designed for very small firms with no professional staff. Consider the following:

- A small CPA firm ordinarily does not have the many levels of staff found in large firms. Consequently, the small firm does not need as elaborate an engagement performance system.
- Many small firms primarily perform preparations, compilations, reviews, or audits of small nonpublic entities. Such engagements are often straightforward, with limited complications and fewer engagement hours, and do not ordinarily need a complex system. A complex engagement performance system could consume a valuable portion of the engagement time that would better be allotted to providing the service.

Firms need to ensure that the engagement performance QC system used is appropriate for the size of the firm, considering the number of partners and staff and the difficulty level of the services that the firm provides.

SELF-STUDY QUIZ

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

7. Under QC 10, a firm's policies and procedures for engagement performance should do which of the following?
 - a. Provide absolute assurance that the firm issues appropriate reports.
 - b. Not allow new employees to be on engagement teams until they are fully trained.
 - c. Facilitate consistent, quality engagement performance.
 - d. Promote peer-to-peer reviews of engagement work.
8. According to QC 10.A35, when reviewing an engagement, which of the following should be considered?
 - a. Whether all findings and issues were raised to an appropriate level for further consideration.
 - b. Whether the engagement team reached a conclusion on the engagement.
 - c. Whether the report has been issued to the client.
 - d. Whether the objectives of the procedures performed were achieved.
9. What is one of the main purposes of audit documentation, according to AU-C 230?
 - a. It provides the basis for the auditor's conclusion about whether the audit objectives were achieved.
 - b. Instructing the engagement team how to plan and perform the audit engagement.
 - c. Providing records that may be used when performing audits of other entities.
 - d. Enabling firms to claim an exemption from potential peer reviews or other inspections.
10. Who is responsible when a firm performs attestation engagements?
 - a. The firm's owner has responsibility for overall quality on attestation engagements.
 - b. Staff members assigned to the engagement take responsibility for engagement planning.
 - c. The engagement partner is responsible for reviewing the work performed as required.
 - d. The attest client retains final responsibility for ensuring professional standards are met.
11. Accountants performing SSARS engagements should follow the specific requirements for the service being performed as well as the general principles of which AR-C section?
 - a. AR-C 60.
 - b. AR-C 70.
 - c. AR-C 90.
 - d. AR-C 120.

SELF-STUDY ANSWERS

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

7. Under QC 10, a firm's policies and procedures for engagement performance should do which of the following? **(Page 34)**
- a. Provide absolute assurance that the firm issues appropriate reports. [This answer is incorrect. The firm's policies and procedures should provide *reasonable* assurance that the firm issues reports that are appropriate given the circumstances of the specific engagement. In the context of QC 10, reasonable assurance means a high, but not absolute, level of assurance.]
 - b. Not allow new employees to be on engagement teams until they are fully trained. [This answer is incorrect. QC 10.A33 indicates that consistency in the quality of engagement performance can be promoted through appropriate teamwork and by training less experienced engagement team members to clearly understand the objectives of their assigned work. Therefore, new employees cannot be fully trained without serving on engagement teams.]
 - c. **Facilitate consistent, quality engagement performance.** [This answer is correct. QC 10.35 requires that effective policies and procedures facilitate consistency in the quality of engagement performance. QC 10.A32 further explains that achieving consistency may be accomplished by using written or electronic manuals, software tools, or other forms of standardized documentation, as well as industry-specific or other subject-matter-specific guidance materials.]
 - d. Promote peer-to-peer reviews of engagement work. [This answer is incorrect. QC 10.36 requires that suitably experienced engagement team members review the work performed by other engagement team members. Generally, a suitably experienced engagement team member would be a team member with more experience than the engagement team member who performed the work. Therefore, peers at the same level would not review each other's work.]
8. According to QC 10.A35, when reviewing an engagement, which of the following should be considered? **(Page 35)**
- a. Whether all findings and issues were raised to an appropriate level for further consideration. [This answer is incorrect. According to QC 10.A35, only *significant* findings and issues are raised for further consideration.]
 - b. Whether the engagement team reached a conclusion on the engagement. [This answer is incorrect. While the engagement team does need to reach a conclusion, according to QC 10.A35, the review should specifically consider whether the procedures performed support the conclusions reached and if they are properly documented.]
 - c. Whether the report has been issued to the client. [This answer is incorrect. When performing this type of review, QC 10.A35 says that it is important to consider whether the evidence obtained is sufficient and appropriate to the report.]
 - d. **Whether the objectives of the procedures performed were achieved.** [This answer is correct. QC 10.A35 suggests that reviewing an engagement includes several considerations, including whether the work is performed in accordance with professional standards and applicable legal and regulatory requirements and whether the objectives of the procedures performed were achieved.]
9. What is one of the main purposes of audit documentation, according to AU-C 230? **(Page 37)**
- a. **It provides the basis for the auditor's conclusion about whether the audit objectives were achieved.** [This answer is correct. AU-C 230 explains the nature and purposes of audit documentation, stating that the audit documentation provides evidence (1) of the auditor's

basis for the conclusion regarding the achievement of the overall audit objectives, and (2) that the audit was planned and performed in accordance with GAAS and applicable legal and regulatory requirements. Audit documentation is an integral component of engagement performance.]

- b. Instructing the engagement team how to plan and perform the audit engagement. [This answer is incorrect. One purpose of audit documentation, according to AU-C 230.03, is assisting the engagement team with planning and performing the audit. Though this is another purpose for audit documentation, it is not one of the main purposes.]
 - c. Providing records that may be used when performing audits of other entities. [This answer is incorrect. Per AU-C 230.03, another purpose for audit documentation is to retain a record of matters of continuing significance to future audits of the same entity (not audits of other entities).]
 - d. Enabling firms to claim an exemption from potential peer reviews or other inspections. [This answer is incorrect. Audit documentation enables the conduct of peer reviews or other external inspections in accordance with applicable legal, regulatory, and other requirements; it does not provide exemptions from such inspections or reviews. Also, though AU-C 230.03 lists this as another purpose for audit documentation, it is not one of the main purposes.]
10. Who is responsible when a firm performs attestation engagements? **(Page 39)**
- a. The firm's owner has responsibility for overall quality on attestation engagements. [This answer is incorrect. The engagement-level quality control requirements at AT-C 105 charge the engagement partner with the responsibility for the overall quality on each attestation engagement, including engagement performance and documentation responsibilities.]
 - b. Staff members assigned to the engagement take responsibility for engagement planning. [This answer is incorrect. AT-C 105.35(b) indicates that the engagement partner should take responsibility for planning and performing the attestation engagement.]
 - c. **The engagement partner is responsible for reviewing the work performed as required. [This answer is correct. AT-C 105.35(c) requires the engagement partner to take responsibility for review of the work performed in accordance with the firm's review policies and procedures. The engagement partner can review or delegate in accordance with the firm's quality control system.]**
 - d. The attest client retains final responsibility for ensuring professional standards are met. [This answer is incorrect. The engagement partner is charged with ensuring that professional standards and applicable legal and regulatory requirements are met.]
11. Accountants performing SSARS engagements should follow the specific requirements for the service being performed as well as the general principles of which AR-C section? **(Page 40)**
- a. **AR-C 60. [This answer is correct. Accountants performing SSARS engagements should follow both the general principles of AR-C 60 and the other specific performance requirements under the relevant type of service.]**
 - b. AR-C 70. [This answer is incorrect. Accountants performing SSARS engagements should follow AR-C 70 specifically for preparation of financial statements; however, a different AR-C section that provides general principles should also be followed.]
 - c. AR-C 90. [This answer is incorrect. AR-C 90 should be followed specifically for the review of financial statements. However, another more general AR-C section should be followed, as well.]
 - d. AR-C 120. [This answer is incorrect. AR-C 120 would apply to compilations of pro forma financial information. An additional AR-C section containing general principles should also be followed.]

CONSULTATION AND RESOLVING DIFFERENCES OF OPINION

As previously discussed, the engagement performance QC element provides guidance for more than merely general engagement performance. Guidance for consultation and differences of opinion are included, as well as engagement quality control review and engagement documentation. This section discusses consultation and differences of opinion. The related QC requirements under QC 10 are presented in Exhibit 2-6. Additionally, the requirements that direct those activities specific to audit and attestation engagements are presented in Exhibit 2-7 and Exhibit 2-8, respectively. A discussion on consultation specific to SSARS engagements is presented later in this section.

Exhibit 2-6

Requirements for Consultation and Differences of Opinion QC Policies and Procedures under QC 10

Requirements	QC 10
Consultation	
<p>The firm should establish policies and procedures to provide reasonable assurance that—</p> <ul style="list-style-type: none"> • Appropriate consultation takes place to address difficult or contentious issues that arise. • Sufficient resources are available to enable appropriate consultation to take place. • The nature and scope of consultation are documented and agreed upon by the individual consulted and the individual seeking consultation. • The conclusions resulting from consultation are documented, understood by the individual seeking consultation and the individual consulted, and implemented. 	QC 10.37
Differences of Opinion	
The firm should establish policies and procedures for addressing and resolving differences of opinion that occur within the engagement team, with those consulted, and between the engagement partner and the engagement quality control reviewer.	QC 10.46
Such policies and procedures should allow a member of the engagement team to document his or her disagreement with the conclusions reached after appropriate consultation.	QC 10.47
Such policies and procedures require conclusions reached to be documented and implemented and the report to not be released until the matter is resolved.	QC 10.48

Exhibit 2-7**Requirements for Consultation and Differences of Opinion QC Procedures under AU-C 220**

Requirements	AU-C 220
Consultation	
<p>The engagement partner should take responsibility for the engagement team when undertaking appropriate consultation on difficult or contentious matters. The engagement partner should be satisfied that—</p> <ul style="list-style-type: none"> • Members of the engagement team have undertaken consultation within and outside the engagement team as appropriate. • The consultation nature and scope are agreed upon with the party consulted, and the conclusions resulting from such consultations are understood by the party consulted. • The resulting conclusions have been implemented. 	AU-C 220.20
The auditor should document the nature and scope of the consultations undertaken during the engagement and the resulting conclusions.	AU-C 220.25(d)
Differences of Opinion	
If differences of opinion arise within the engagement team, with those consulted, or between the engagement partner and the engagement quality control reviewer, the firm's policies and procedures for resolving such differences should be followed.	AU-C 220.23

Exhibit 2-8**Requirement for Consultation under AT-C 105**

Requirement	AT-C 105
The engagement partner should take responsibility for the overall quality on each attestation engagement, including the appropriate consultation being undertaken by the engagement team on difficult or contentious matters.	AT-C 105.35(e)

Consultation

When an engagement team encounters complex technical issues or unique industry situations in an engagement that they have never encountered before, the engagement team may need to consult with someone not involved in the engagement. Consultation on such matters may be with individuals who possess relevant specialized expertise at the appropriate professional level, either within the firm or outside of it.

Some firms designate experts or specialists in particular industries and/or unusually complex areas such as fair value measurements or pension plans. Many firms have specialists in income taxes. Larger firms may maintain a list of in-house experts or specialists to ensure that professional staff know who to consult with when complicated engagement situations arise. The extent of specialization varies with firm size and individual firm preference. Naturally, the smaller a firm is, the less likely the firm will have in-house specialists available for consultation. Additionally, on particularly complex matters, outside consultation may be necessary even for large firms.

QC 10.37 indicates that firms should establish policies and procedures over consultation to provide the firm with reasonable assurance that—

- Appropriate consultation takes place (such as when dealing with difficult or contentious issues).
- Sufficient resources are available to enable appropriate consultation to take place.
- The nature and scope of such consultations are documented and are agreed upon by both those seeking consultation and the individual consulted.
- The consultation conclusions reached are documented, understood by both the individual seeking consultation and the individual consulted, and implemented.

QC 10.A37 explains that consultation includes making use of appropriate research resources, such as the technical reference materials available to firm personnel, as well as using the collective experience and technical expertise of the firm. Appropriate resources include current versions of the technical pronouncements and industry guidance needed relevant to the firm's clients. Maintaining an adequate and up-to-date professional reference library to meet the firm's needs is discussed below. Consultation assists in promoting engagement quality and improves the application of professional judgment. Appropriate recognition of consultation in the firm's policies and procedures helps to promote a culture in which consultation is recognized as a strength and personnel are encouraged to consult on difficult or contentious issues. When firms encourage consultation among engagement teams and within the organization, the partners' and staff's learning and development process is generally strengthened, as well as the knowledge base, quality control system, and professional capabilities of the firm as a whole.

QC 10.A38 further explains that consultation on significant technical, ethical, and other matters can be effectively achieved when the individuals consulted have appropriate knowledge, authority, and experience and are provided with all the relevant facts that will enable them to provide informed advice. It would not be considered appropriate to withhold facts or attempt to manipulate the flow of information in an effort to gain a particular response.

Additionally, consultations are effectively achieved when the resulting conclusions are appropriately documented and implemented. QC 10.A39 explains that documentation of consultations that is sufficiently complete and detailed contributes to an understanding of (a) the issue on which consultation was sought and (b) the results of the consultation, including decisions taken, the basis for those decisions, and how the decisions were implemented. To ensure that the documentation of consultation is sufficiently complete and detailed, practitioners may wish to use a standardized form that encompasses those matters.

Outside Consultation. Consultation outside the firm may be the appropriate resolution if the firm does not have the relevant experience or technical expertise necessary or the firm believes that additional consultation is needed, for example, on particularly difficult matters. For small firms and especially sole practitioners, consulting outside of the firm may be the norm. Some firms prepare a list of outside specialists that may be consulted when an accounting, SSARS, or audit issue is encountered. Those outside specialists could be advisory services provided by other firms, the AICPA Technical Hotline, AICPA Audit Quality Centers, other professional and regulatory bodies, or commercial organizations that provide relevant quality control services. Before contracting for such services, QC 10.A40 indicates that considering the external provider's competence and capabilities helps the firm determine whether the external provider is suitably qualified. Additionally, some firms (particularly larger firms) may have policies that require advance approval by firm management (such as the quality control director or the lead audit partner) before outside consultation is initiated. Some firms may also specify that the outside consultant's views and conclusions are considered by the firm, but are not binding on the final decision made by the firm.

Maintaining an Adequate and Up-to-date Professional Reference Library. Having appropriate research resources is one of many important reasons firms need to maintain an adequate and up-to-date professional reference library (whether in paper format or electronic media). The firm library is an essential tool that enables personnel to stay current with professional standards and applicable legal and regulatory requirements that are constantly changing. Having ready access to such information may help minimize the need for some external consultation and resolve any potential differences of opinion. Having adequate and up-to-date technical reference materials may allow personnel to resolve some issues more efficiently without the involvement of supervisory personnel. In fact, the

firm may encourage staff to initially perform their own research to answer technical questions as this process provides more in-depth knowledge and understanding of the matter and a learning opportunity for the staff.

Firms need to identify the best resources to answer the types of questions that personnel are likely to encounter. Generally, resource needs vary by firm based upon the types of engagements performed. The firm's clients, the expertise of the firm's personnel, and staff usage levels also affect the firm's library needs. To maintain current and adequate libraries, firms also need to periodically consider whether new resources are required to cover any current professional standards changes or new areas of service.

A professional accounting and auditing library should include the primary resources discussed below:

- a. *AICPA Pronouncements.* The AICPA, through its senior and technical committees and task forces, issues pronouncements that govern a wide range of topics, including auditing, attestation, compilation, review, preparation, and other professional services; professional ethics; and quality control. The AICPA's pronouncements can be found in the following resources.
 - (1) *AICPA Professional Standards.* This resource contains all of the currently effective pronouncements on professional standards issued by the AICPA.
 - (2) *General and Industry Audit and Accounting Guides.* These guides include recommendations on applying U.S. GAAP, and recommendations and interpretive guidance on applying U.S. auditing, attestation, and compilation and review standards to related engagements and specific industries.
 - (3) *Technical Practice Aids.* These practice aids primarily provide clarification and guidance on practical application of U.S. auditing and attestation standards.
 - (4) *AICPA Risk Alerts.* Although most small firms do not need all of the alerts, each firm needs the alerts that are applicable to its practice.

The preceding publications are available from the AICPA at www.aicpa.org and from Thomson Reuters by calling (800) 431-9025 or online at tax.thomsonreuters.com.

- b. *FASB Codification.* The *FASB Accounting Standards Codification* (FASB Codification) is the single source of authoritative U.S. generally accepted accounting principles (GAAP) to be applied by nongovernmental entities. The FASB Codification is available in two online versions (professional or basic) at www.fasb.org. The basic online version is available at no charge and provides browsing by topic, basic print functionality, and utility to identify the location of the original standards. The professional online version, while not free, provides more extensive functionality and features. The FASB also continues to provide bound volumes of certain pre-FASB Codification materials.

Thomson Reuters/PPC customers may purchase access to the FASB Codification, which is available online using Checkpoint. The FASB Codification on Checkpoint is available as an add-on with a subscription to any Thomson Reuters/PPC product on Checkpoint. The FASB Codification on Checkpoint provides enhanced functionality and advanced navigation related to the FASB Codification material and also accesses the complete library of prior statements, standards, and other supporting material.

- c. *Other Specialized Authoritative Literature.* Depending on the type of clients the firm serves, the firm may also need to include other specialized authoritative literature in its library. For example, a firm with governmental clients would include *Government Auditing Standards* (The Yellow Book) in the firm audit library as a resource to be used when performing governmental audits.
- d. *Other Resources.* In addition to the authoritative literature discussed above, the firm should consider including other reference sources as necessary to either summarize and explain the authoritative literature or provide guidance on specific areas not addressed by authoritative literature. Thomson Reuters has an entire line of accounting, auditing, consulting, and practice management products that are comprehensive, yet clearly and concisely written. In addition, its guides are updated annually so that the firm's library remains up-to-date.

Audit Requirements. Requirements relating to consultation, but specific to the performance of audit engagements, are located at AU-C 220.20. That guidance places responsibility on the audit engagement partner to ensure that appropriate consultation is undertaken on difficult or contentious matters. Further, the engagement partner should be satisfied that—

- Members of the engagement team have followed consultation policies during the course of the engagement.
- The nature and scope of the consultation is agreed upon with the party consulted.
- The conclusions resulting from such consultations are understood by the party consulted.
- The conclusions resulting from such consultations have been implemented.
- The audit documentation includes the nature and scope of, and conclusions resulting from, consultations undertaken during the engagement. (AU-C 220.25d)

AU-C 220.A20 indicates that members of the audit engagement team also have a responsibility regarding consultation. Their responsibility is to bring to the attention of appropriate personnel matters encountered during the performance of the engagement that they believe are difficult or contentious and may require consultation.

Consultation guidance similar to that of the quality control standards (QC 10.A38) is included in the auditing standard at AU-C 220.A21. The information at AU-C 220.A22 covers consulting outside of the firm (for example, when the firm lacks appropriate internal resources). It suggests that the engagement team may take advantage of advisory services offered by other firms, professional and regulatory bodies, or commercial organizations that provide relevant quality control services.

Attestation Requirement. A requirement relating to consultation, but specific to the performance of attestation engagements, is located at AT-C 105.35(e). That guidance places responsibility on the engagement partner for the overall quality on each attestation engagement, including responsibility for seeing that appropriate consultation is undertaken by the engagement team when difficult or contentious matters are encountered.

SSARS Engagements. While the SSARS do not specifically include authoritative requirements that address consultation, in appropriate circumstances, other professional standards indicate that accountants may need to resolve complex technical issues through consultation when performing SSARS engagements. Those other professional standards are detailed below—

- The SSARS require the accountant to possess or obtain a level of knowledge of the accounting principles and practices of the client's industry. Such knowledge may be obtained, among other ways, by consulting in-firm or outside firm individuals.
- QC 10.37 indicates that CPA firms should establish quality control policies and procedures over consultation.
- ET 1.300.010.03 recognizes that consultation with others may be necessary during the performance of professional services.

Audit and Attestation Requirements for Using Specialists. AU-C 620A, *Using the Work of an Auditor's Specialist*, discusses the use of an auditor's specialist in performing an audit of financial statements. An *auditor's specialist* assists the auditor in obtaining sufficient appropriate audit evidence. Similarly, AT-C 105.34 also recognizes that a *practitioner's external specialist* may be used on attestation engagements. Specialists, in the context of audit and attestation literature, are individuals possessing special skill or knowledge in a particular field other than accounting or auditing, for example, actuaries, appraisers, attorneys, engineers, geologists, environmental consultants, etc. Normally, when one thinks of the term *specialists* in the context of a firm's QC system, one is not referring to the auditor's or practitioner's specialists discussed in the context of auditing and attestation literature. Rather, one is referring to an individual with special knowledge or expertise in accounting or auditing.

Most firms think of consultation-related quality control procedures in terms of resolving accounting or auditing issues. However, as mentioned above, during audit or attestation engagements, firms may occasionally need to consult with

auditor's or practitioner's specialists such as actuaries, engineers, and valuation specialists. AU-C 620A provides guidance to auditors who use the work of a person (or organization) possessing special skill or knowledge in a particular field other than accounting or auditing. This course recommends that a firm's quality control procedures contain a step that makes all professionals aware of their added responsibilities under AU-C 620A when an auditor's specialist is used by the firm.

AU-C 620A.09 provides guidance for evaluating the professional qualifications of an auditor's specialist and indicates that the auditor should evaluate whether the auditor's specialist possesses the necessary competence, capabilities, and objectivity. In the case of an external specialist, the auditor should inquire about interests and relationships that may create a threat to the specialist's objectivity. In evaluating the competence, capabilities, and objectivity of the auditor's specialist, the auditor may consider whether the specialist's work is subject to technical performance standards or other professional or industry requirements. AU-C 620A.A18 suggests other matters that may be relevant in evaluating the competence, capabilities, and objectivity of an auditor's specialist.

AT-C 105 indicates that a practitioner's specialist may be used during the performance of an attestation engagement. AT-C 105.12 defines a *practitioner's specialist* as an individual (or organization) who (that) possesses expertise in a field other than accounting or attestation, and whose work in that field is used by the practitioner to assist in obtaining evidence for the engagement being performed. Additionally, a *practitioner's external specialist* is not considered part of the engagement team and thus, the use of such specialist's work is limited as further described in the attestation standard. See *PPC's Guide to Nontraditional Engagements* for detailed information on the use of practitioner's specialists under the attestation standards.

Specifying Situations that Need Consultation. It is impossible to identify every situation that could prompt the need for consultation; therefore, firms may question the practicality of specifying such situations. However, it is a best practice that the consultation component of the QC document contain a list of common situations that often indicate consultation is needed. The list might include the following:

- Any engagement in which a modified or nonstandard report is likely.
- A probable going concern issue.
- An engagement involving material litigation.
- Application, for the first time, of new or complex technical pronouncements.
- Industries with special accounting, auditing, or reporting requirements.
- Accounting for complex or unusual transactions.
- Emerging practice problems.
- Choices among alternative generally accepted accounting principles upon initial adoption or when an accounting change is made.
- Questions regarding the integrity of management.
- Suspected or discovered fraud or other irregularities.
- Uncertainty at the financial statement date regarding a significant accounting estimate, such as asset impairment (for example, recovery of a revenue producing asset or goodwill), asset realization (for example, deferred tax asset valuation allowances), liability recognition (for example, environmental cleanup obligations), or other contingencies.
- Reissuance of a report, consideration of omitted procedures after a report has been issued, or subsequent discovery of facts that existed at the time a report was issued.
- Filing requirements of regulatory agencies.
- Meetings with regulators at which the firm is to be called on to support the application of generally accepted accounting principles or generally accepted auditing standards that have been questioned.

The types of engagement services performed, the industries serviced, and other unique firm criteria will impact the list of common consultation situations encountered for each firm.

Firms that specify common situations that necessitate consultation in the firm's QC document need to ensure that the firm's personnel are aware of and recognize those situations. Peer reviewers test the firm's compliance with its QC system, and noncompliance noted may result in the firm receiving peer review findings.

Differences of Opinion

Occasionally, differences of opinion concerning accounting and auditing issues may arise among—

- Firm personnel within the engagement team.
- The firm and individuals consulted.
- The engagement partner and the engagement quality control reviewer.

QC 10.46–.48 state that firms should establish policies and procedures for dealing with and resolving differences of opinion. Those policies and procedures should require that (a) conclusions reached be documented and implemented, and (b) the report not be released until the difference of opinion is resolved. Additionally, such policies and procedures should enable engagement team members to document their disagreement (if any) with the conclusions reached after appropriate consultation has taken place.

QC 10.A51–.A52 further explain that effective procedures encourage identification of differences of opinion at an early stage. Effective procedures also provide clear guidelines about the steps to be taken after a difference of opinion is identified. In addition, effective procedures require documentation regarding the resolution of the differences and the implementation of the conclusions reached. Procedures to resolve such differences may include consulting with another practitioner, firm, or professional or regulatory body.

Differences of opinion may occur due to a myriad of circumstances. Some of the more common circumstances include:

- Differing opinions regarding the interpretation and application of authoritative standards, including ethics-related matters.
- Disagreements about the economic substance of a transaction or the level of detail necessary for engagement documentation.
- Differing opinions during an engagement over the quality control review process.
- Differences of opinion about the competencies and suitability of engagement personnel.

Documenting Differences of Opinion. While conclusions reached are required to be documented, specific guidance regarding this documentation is not provided in QC 10. Firms should exercise care in establishing policies and procedures for documenting differences of opinion because if the firm establishes documentation procedures that are too stringent, staff may be discouraged from initiating general discussions of technical questions or issues for fear that these exchanges of ideas demand too much documentation time and effort.

Best practice suggests that matters of a material nature be documented, but that the firm's QC policies and procedures not require documentation for matters of a general nature or of minor technical importance. The decision of whether a question is of a general nature or of minor technical importance versus one that is material would ordinarily be made by the engagement partner. Once the determination has been made that the issue is material, the firm should follow its documentation procedures. Resolution to differences of opinion often involves consultation of in-firm and/or outside experts. The form also provides a place for team members to document their disagreement with the conclusions reached, if desired. It is usually helpful to request that the preparers of the documentation reference authoritative literature used to reach their conclusions.

Audit Requirements. AU-C 220.23 includes requirements relating to differences of opinion that occur during the performance of audit engagements. The guidance indicates that when differences of opinion occur within the engagement team, with those consulted, or between the engagement partner and the engagement quality control reviewer, the engagement team should follow the firm's policies and procedures for resolving differences of opinion.

THE ENGAGEMENT QUALITY CONTROL REVIEW

As discussed earlier in this lesson, the engagement performance QC element provides guidance for more than merely general engagement performance. This section covers the guidance for performing engagement quality control review. The related QC requirements under QC 10 are presented in Exhibit 2-9. The requirements that direct engagement quality control review specific to audit and attestation engagements are presented in Exhibit 2-10 and Exhibit 2-11, respectively.

Exhibit 2-9

Requirements for Engagement Quality Control Review QC Policies and Procedures under QC 10

Requirements	QC 10
The firm should establish criteria for evaluating which engagements should be subject to engagement quality control review (EQCR).	QC 10.38
The QC policies and procedures should require an EQCR to be performed for all engagements that meet the criteria established by the firm.	QC 10.39
The firm should establish policies and procedures setting out the nature, timing, and extent of EQCRs and require that an EQCR be completed before the report is released.	QC 10.40
Policies and procedures requiring engagement quality control review should include— <ul style="list-style-type: none"> • Discussing significant findings and issues with the engagement partner. • Reading the financial statements (or other subject matter information) and the proposed report. • Reviewing selected engagement documentation regarding significant judgments made and the conclusions reached. • Evaluating the conclusions reached in formulating the proposed report and considering whether the proposed report is appropriate. 	QC 10.41
Criteria for the Eligibility of Engagement Quality Control Reviewers	
QC policies and procedures that address the appointment of engagement quality control reviewers is required. When establishing the eligibility of engagement quality control reviewers consider— <ul style="list-style-type: none"> • The technical qualifications required to perform the function, including the necessary experience and authority. • The degree to which an engagement quality control reviewer can be consulted on the engagement without compromising reviewer objectivity. 	QC 10.42

Requirements	QC 10
<p>The firm should establish policies and procedures to maintain the objectivity of the engagement quality control reviewer. The policies and procedures should indicate that the engagement quality control reviewer should satisfy independence requirements for the reviewed engagements, even though not a member of the engagement team. The policies and procedures should indicate that the engagement quality control reviewer—</p> <ul style="list-style-type: none"> • When practicable, is not selected by the engagement partner. • Does not otherwise participate in the performance of the engagement during the review period. • Does not make decisions for the engagement team. • Is not subject to other considerations that would threaten objectivity. 	QC 10.43
When the reviewer's ability to perform an objective review is likely to have been impaired, the firm's policies and procedures should provide for the replacement of the reviewer.	QC 10.44
Documentation	
<p>The firm should establish policies and procedures for documentation of the EQCR, including requiring documentation that—</p> <ul style="list-style-type: none"> • The procedures required by firm policies were performed. • The EQCR was completed before the report was released. • The reviewer was not aware of any unresolved matters that would cause him or her to believe that the significant judgments made and the conclusions reached by the engagement team were not appropriate. 	QC 10.45

Exhibit 2-10

Requirements for Engagement Quality Control Review QC Procedures under AU-C 220

Requirements	AU-C 220
<p>For audit engagements, if any, that the firm has determined an EQCR is required, the engagement partner should—</p> <ul style="list-style-type: none"> • Determine that an engagement quality control reviewer has been appointed. • Discuss significant findings or issues arising during the audit with the engagement quality control reviewer. • Ensure that the auditor's report is not released before the EQCR is completed. 	AU-C 220.21
<p>The engagement quality control reviewer should perform an objective evaluation of the significant judgments made by the engagement team and the conclusions reached. This evaluation should involve—</p> <ul style="list-style-type: none"> • Discussing the significant findings or issues with the engagement partner. • Reading the financial statements and the proposed auditor's report. • Reviewing selected audit documentation relating to the significant judgments made and the conclusions reached. • Evaluating the conclusions reached and considering whether the proposed report is appropriate. 	AU-C 220.22

Requirements	AU-C 220
Documentation	
<p>The engagement quality control reviewer should document—</p> <ul style="list-style-type: none"> • That the firm's EQCR procedures have been performed. • The date the EQCR was completed. • That the reviewer was not aware of any unresolved matters that would cause him or her to believe that significant judgments made and conclusions reached were not appropriate. 	AU-C 220.26

Exhibit 2-11

Requirements for Engagement Quality Control Review under AT-C 105

Requirements	AT-C 105
For attestation engagements, if any, for which the firm has determined an EQCR is required—	
<ul style="list-style-type: none"> • The engagement partner should take responsibility for discussing with the engagement quality control reviewer significant findings or issues arising during the engagement, including those that are identified because of the EQCR. The practitioner's report should not be released until completion of the quality control review, and 	AT-C 105.45(a)
<ul style="list-style-type: none"> • The engagement quality control reviewer should perform an objective evaluation of the significant judgments made by the engagement team and the conclusions reached in formulating the report. Such an evaluation should include— <ul style="list-style-type: none"> • Discussing significant findings or issues with the engagement partner. • Reading the written subject matter information (or assertion) and the proposed practitioner's report. • Reading selected engagement documentation relating to the significant judgments made and the conclusions reached. • Evaluating the conclusions reached and considering whether the proposed report is appropriate. 	AT-C 105.45(b)

Definition of Engagement Quality Control Review

QC 10.38 requires the firm to establish criteria against which all engagements covered by the QC standard are to be evaluated to determine whether an engagement quality control review should be performed. An *engagement quality control review* is defined as a process designed to provide an objective evaluation, before the report is released, of the significant judgments made by the engagement team and the conclusions the engagement team reached in formulating the report. An engagement quality control review is only performed for those engagements for which the firm has determined that an engagement quality control review is required, as documented in the firm's QC policies and procedures.

General Requirements

QC 10.39–.40 state that when an engagement meets the engagement quality control review criteria established, an engagement quality control review (EQCR) should be performed for that engagement and completed before the report is released. The firm should establish policies and procedures that set out the nature, timing, and extent of an

EQCR. QC 10 also provides requirements for establishing policies and procedures that direct (a) procedures that should be performed during an EQCR, (b) the qualifications of the engagement quality control reviewer, and (c) documentation of the EQCR. Those requirements are discussed throughout this section. Additionally, further explanation regarding establishing criteria for an EQCR and the nature, timing, and extent of EQCR, is provided.

Audit Requirements. AU-C 220.21 indicates that when an EQCR is required for an audit engagement, the engagement partner should:

- a. Ascertain that an engagement quality control reviewer has been appointed.
- b. Discuss with the EQC reviewer significant findings or issues that arose during the engagement.
- c. Ensure that the auditor's report is not released before the EQCR is completed. Application guidance at AU-C 220.A23–.A25 explaining this requirement notes that—
 - Conducting an EQCR timely and at appropriate stages of the audit allows significant findings or issues to be promptly and satisfactorily resolved.
 - An EQCR is completed when the engagement quality control reviewer satisfies the requirements of AU-C 220.22, which are discussed later in this section.
 - The date of the auditor's report needs to be changed if the EQCR is completed after the report is dated and the EQCR identifies the need for performing additional procedures or obtaining additional evidence. The revised report date would not be before those additional procedures were performed or additional evidence was obtained.

Attestation Requirements. AT-C 105.45(a) indicates that when the firm has determined that an EQCR is required during an attestation engagement, the engagement partner should—

- Take responsibility for discussing with the engagement quality control reviewer significant findings or issues arising during the engagement, including those that are identified because of the EQCR.
- Ensure that the practitioner's report is not released before the EQCR is completed.

Performing Engagement Quality Control Reviews

QC 10.41 indicates that the firm should establish policies and procedures to require the engagement quality control review to include—

- a. Discussing with the engagement partner about significant findings and issues.
- b. Reading the financial statements or other subject matter information and the proposed report.
- c. Reviewing selected engagement documentation relating to the significant judgments of the engagement team and the conclusions reached.
- d. Evaluating the conclusions reached in formulating the report and considering whether the proposed report is appropriate.

With regard to the nature, timing, and extent of an engagement quality control review, QC 10.A42 suggests that EQCRs may include consideration of—

- The engagement team's evaluation of the firm's independence relating to the engagement.
- Whether consultation has taken place on matters regarding differences of opinion or other difficult or contentious matters, and the conclusions reached as a result of such consultation.
- Whether documentation selected for review reflects the work performed and the conclusions reached relating to significant judgments made.

In the situation where an EQCR identifies that additional procedures are needed or evidence is required, but the EQCR is completed after the date of the accountant's report, then the report date will need to be changed to a later date when such additional procedures have been satisfactorily completed or additional evidence has been obtained in accordance with the professional standards applicable to the engagement.

Conducting the EQCR in a timely fashion throughout the engagement allows significant issues to be resolved to the engagement quality control reviewer's satisfaction and reduces the time pressure for resolving identified issues before the report is released. The extent of the EQCR may depend on, among other things, the complexity of the engagement and the risk that the report might not be appropriate in the circumstances. The engagement partner's responsibility for the performance of the engagement is not reduced by the performance of an EQCR.

Other matters relevant to evaluating significant judgments made by the engagement team may include the following:

- Significant risks identified and the responses to those risks.
- Judgments made, particularly with respect to significant risks and materiality.
- The significance of identified corrected and uncorrected misstatements and the disposition of such misstatements.
- Matters to be communicated to management and those charged with governance, and other parties such as regulatory bodies, if any.

If the engagement quality control reviewer makes recommendations and the engagement partner does not accept those recommendations, the firm's procedures for resolving differences of opinion apply when the matter is not resolved to the reviewer's satisfaction. Additionally, the report cannot be released until the matter is resolved.

Audit Requirements. AU-C 220 also includes requirements and other guidance relating to performing engagement quality control reviews specific to the performance of audit engagements. AU-C 220.22 indicates that the engagement quality control reviewer should perform an objective evaluation of the significant judgments made and conclusions reached in formulating the auditor's report. This evaluation should involve the same matters that are provided by QC 10 (but specific to audit engagements).

With regard to the nature, timing, and extent of an engagement quality control review, the application and other explanatory material section at AU-C 220.A26–A30 provides much of the same guidance included in QC 10 (but specific to audit engagements). The application guidance further explains that when the engagement partner remains alert for changes in circumstances, he or she is able to identify situations in which an EQCR is necessary, even though at the start of the audit engagement an EQCR was not required. Additionally, the guidance indicates that in the performance of an audit, the engagement quality control reviewer may also consider whether—

- Independence was appropriately evaluated with regard to the engagement.
- Appropriate consultation has taken place when differences of opinion or other difficult or contentious matters occurred, including the related conclusions drawn.
- Engagement documentation supports the work performed on significant judgments and conclusions reached.

A difference found in the auditing guidance relates to the situation where the auditor is engaged to communicate key audit matters (KAMs) under AU-C 701, *Communicating Key Audit Matters in the Independent Auditor's Report*. AU-C 220.A28 indicates the engagement quality control reviewer also considers the determination of KAMs to be communicated in the auditor's report (or the decision not to include any KAMs or the conclusions that there are no KAMs) when evaluating significant conclusions reached by the engagement team.

Attestation Requirements. AT-C 105.45(b) requires that when an EQCR is performed, it should be an objective evaluation of the significant judgments made by the attestation engagement team and the conclusions reached in formulating the report. That evaluation should include the same general matters required by QC 10.41. For an attestation engagement, those matters include—

- Discussing significant findings or issues with the engagement partner.
- Reading the written subject matter information (or assertion) and the proposed practitioner's report.
- Reading selected engagement documentation relating to the significant judgments made and the conclusions reached.
- Evaluating the conclusions reached and considering whether the proposed report is appropriate.

The second bullet above includes a minor terminology revision made by SSAE No. 21, which changed "reading the written subject matter or assertion" to "reading the written subject matter information (or assertion)."

Further information provided at AT-C 105.A67 indicates that an EQCR may also involve consideration of the following matters:

- a. The engagement team's evaluation of the firm's independence with regard to the specific engagement.
- b. Whether consultation has appropriately occurred when differences of opinion or other difficult or contentious matters arose, including the conclusions resulting from those consultations.
- c. Whether the engagement documentation selected for review reflects the work performed with regard to the significant judgments made and supports the conclusions reached.

Establishing Criteria for Engagement Quality Control Reviews

In establishing criteria for performance of an EQCR, the structure and nature of the firm's practice are important. QC 10.A41 indicates that such criteria may include considerations such as the following:

- The nature of the engagement, including whether it involves a matter of public interest.
- Whether unusual circumstances or risks have been identified relating to the engagement, engagement service type, or industry.
- Whether laws or regulations require an engagement quality control review to be performed, if applicable.

While firms are required to establish criteria as part of their QC policies and procedures for determining when an EQCR should be performed, if no engagements meet the criteria established by the firm for review, no EQCRs are required to be performed. However, intentionally establishing EQCR criteria that result in no engagements being selected for review does not align with the spirit of the quality control standard's guidance. Additionally, doing so when a firm is undergoing a system review could be viewed as a deficiency in the firm's QC system, particularly if engagement deficiencies are detected during the review that would have been caught and corrected by effective EQCR procedures. Firms need to tailor EQCR criteria to address higher risk engagements based on the firm's particular circumstances.

COVID-19 has significantly altered the business operations of many entities and increased the level of risk on those engagements. As such, COVID-19 engagement risk considerations continue to be relevant and firms may want to consider such criteria for performing EQCR, especially for engagements of entities in industries that continue to be the most impacted by the ongoing pandemic.

As previously mentioned, the structure and nature of the firm's practice are important factors in establishing criteria to consider when determining which engagements are to be subject to an EQCR. Accordingly, this course recommends that firm management begin the process of developing EQCR policies and procedures by considering the firm's unique structure and nature. Firm structure includes the size of the firm, whether the firm is a single-office firm or part of a multi-office practice, the number of partners in the firm, whether the firm belongs to a network, etc. The nature of the firm includes the types of services the firm performs and how those services make up the total

engagements of the firm. For example, does the firm provide an extensive line of services including audit, attestation, and SSARS engagements? Or does the firm provide only SSARS and tax engagement services? (Tax services are not subject to QC 10.)

Some firms may establish criteria that result in more EQCRs being performed than other firms because EQCR criteria are based on each firm's unique circumstances (that is, structure and nature). For example, a full service firm with a larger tax practice and a smaller audit practice may designate that all audits exceeding an 80-hour time budget have an EQCR performed. For that particular firm, because the firm offers a variety of services overseen by multiple partners, some of whom perform both audit and tax services, there may be a more pressing need to have EQCRs performed on a larger number of audit engagements. Alternatively, a firm that primarily performs audits may feel more confident in its ability to follow established auditing guidance because all of its partners routinely perform audits. Thus, that firm may designate only audit engagements that it considers to be high-risk (as defined by the firm) for EQCR. The preceding discussion indicates that firms may treat the same engagement differently for purposes of establishing engagement quality control review criteria. The key point is that EQCR criteria are as unique as the firm.

For each type of service provided, the firm may consider a different set of EQCR criteria. In other words, the criteria established for audit engagements may differ significantly than for other types of attest engagements. As mentioned above, QC 10.A41 suggests that when establishing criteria for EQCR, firms consider, for example, the nature of the engagement, unusual circumstances or risks of the engagement, and whether other laws or regulations impact EQCR requirements. Additionally, for most firms, the appropriate criteria consists of a mix of considerations and not merely one criterion. The following items represent types of situations that may be considered in establishing EQCR criteria (not intended to be all-inclusive):

- Third-party use of the report, such as to the client's lender for financing purposes.
- High-profile clients, for example, well-known individuals or entities in the local community and those involving a matter of public interest.
- Clients individually significant to the firm's revenues or to partner compensation, representing an undue influence threat.
- Entities subject to governmental or regulatory requirements.
- Engagements subject to group auditing guidance.
- Audits in which a going concern issue was identified but the audit report was not modified.
- New areas of service for the firm; for example, the firm begins to offer prospective financial information services.
- Engagements for an entity that has situations the firm rarely encounters, such as joint ventures.
- Engagements that required consultation with third parties.
- New firm partners.
- New or complex specialized industries, especially engagements where the firm's practice is limited and the firm's personnel have little or no experience.
- First-time clients.
- Client entities without competent or experienced accounting personnel.
- Client entities with substantial fraud risk factors.
- Client entities with significant related-party relationships or transactions.
- Clients that have experienced material misstatements during current or previous engagements.
- Engagements for which a familiarity threat may exist.

- Engagements where the acceptance and continuance decision caused reason for concern (even though the firm resolved the initial concern).
- Any high risk engagement, as defined by the firm (for example, engagements that meet must-select criteria for peer review).

Any circumstance that creates an unusual or a higher level of engagement risk ought to be considered in establishing EQCR criteria. Whenever an engagement is subject to a heightened level of risk, the firm may consider it prudent to have a second pair of eyes review the engagement.

Regardless of whether a particular engagement meets the firm's stipulated EQCR criteria, any engagement may be selected for EQCR based on risk encountered during the engagement. However, the reverse situation does not hold true. That is, a firm may not choose to opt-out of performing an EQCR when an engagement meets the established EQCR criteria. Not performing an EQCR on an engagement that meets the established EQCR criteria is a matter commonly identified during peer review.

Because EQCR criteria is based on each firm's unique circumstances, it is necessary for the firm to consider revising its established EQCR criteria when firm circumstances change. The discussion below provides an illustration of changing circumstances that trigger the need to revise a firm's EQCR criteria. The firm's quality control system needs to be a dynamic system that changes as the firm changes.

EQCR Issues. Many firms continue to struggle with implementing and complying with the QC requirements for engagement quality control review. Some of the more common issues and/or misconceptions that occur include—

- Firms mistakenly thinking that the engagement partner's preissuance review qualifies as an EQCR.
- Firms mistakenly believing that the firm's postissuance inspection qualifies as an EQCR.
- Firms mistakenly allowing an engagement team member or partner to perform the EQCR of an engagement they worked on.
- Firms mistakenly performing EQCR after the report has been issued.
- Firms confusing third-party inspections with EQCR, not understanding that EQCR is a component of engagement performance completed prior to the report being released.
- Firms establishing inappropriate EQCR criteria for the firm's engagements and risks, making it likely that few or any EQCRs will be performed.
- Firms establishing appropriate EQCR criteria but not following through with performing an EQCR on engagements that meet the specified EQCR criteria.
- Firms with small A&A practices mistakenly assigning someone without A&A competency (such as a tax professional) to perform EQCR.

The information provided within this section is designed to help firms understand the requirements and the process of implementing and complying with EQCR.

Example of Establishing EQCR Performance Criteria. QC 10 does not describe the process a firm should go through to determine its unique EQCR performance criteria. Exhibit 2-12 provides some scenarios for developing engagement quality control review criteria based upon a firm's unique nature and structure, as discussed earlier. Thus, *if* the firm situation warrants it, EQCR may be limited. The illustrations in Exhibit 2-12 represent suggestions given a specific set of circumstances and are not meant to indicate that the selected engagement quality control review criteria are the only appropriate EQCR criteria. No right or wrong EQCR criteria exists because no two firms are the same. Additionally, this illustration highlights the importance of firm leadership periodically reevaluating whether the EQCR policy is still appropriate, especially when changes occur in the firm's A&A practice. It is a best practice that firms reevaluate the appropriateness of the EQCR criteria when changes occur in the firm's risk-related circumstances, or at least annually.

Exhibit 2-12**Example of Establishing EQCR Performance Criteria****Scenario #1**

A single-office firm performed the following audit and attest services during its last fiscal year:

- 45 compilations (both interim and annual, including one full-disclosure GAAP)
- 5 reviews (3 of which are required by client banks)
- 15 audit engagements

The firm's clients are primarily in the manufacturing, hospitality, and retail industries and A&A personnel have experience in those industries. The firm had no deficiencies in its most recent peer review.

A&A personnel include:

Managing Partner (primarily tax)	20 years experience
Other Partner	15 years experience
Senior Manager	10 years experience
Senior 1	6 years experience
Senior 2	3 years experience
Staff 1	2 years experience

Firm EQCR Policy—

Based on its services, client base, and personnel, the firm has established a policy that an EQCR should be performed for the following engagements during 20X1:

- Audit engagements of entities not in the manufacturing, hospitality, and retail industries.
- Review engagements of entities with significant debt covenants.
- All full-disclosure compilation engagements and year-end compilation engagements of entities not in the manufacturing, hospitality, and retail industries.
- Initial engagements for any new clients.
- All other types of engagements performed for the first time.
- Other engagements at the discretion of the managing partner.

Scenario #2

Assume the same fact pattern in Scenario #1, except that the senior manager was promoted to New Partner, effective 1/1/20X2. The firm revises its EQCR policy as follows (revision in **bold**):

Firm EQCR Policy—

Based on its services, client base, and personnel, the firm has established a policy that an EQCR be performed for the following engagements during 20X2:

- Audit engagements of entities not in the manufacturing, hospitality, and retail industries.
- Review engagements of entities with significant debt covenants.

- All full-disclosure compilation engagements and year-end compilation engagements of entities not in the manufacturing, hospitality, and retail industries.
- Initial engagements for any new clients.
- All other types of engagements performed for the first time.
- **All engagements for which New Partner is responsible.**
- Other engagements at the discretion of the managing partner.

Scenario #3

Assume the same fact pattern in Scenario #1, except that the firm is acquiring the practice of a smaller CPA firm effective 7/1/20X2. The acquired firm's clients include some employee benefit plan and construction contractor audits, as well as other type engagements the acquiring firm is already experienced in. The sole proprietor of the acquired firm is retiring, but the acquiring firm hired the other A&A personnel, comprised of one staff and one senior. The firm revises its EQCR policy as follows (revision in **bold**):

Firm EQCR Policy—

Based on its services, client base, and personnel, the firm has established a policy that an EQCR be performed for the following engagements as of 7/1/20X2:

- Audit engagements of entities not in the manufacturing, hospitality, and retail industries.
- Review engagements of entities with significant debt covenants.
- All full-disclosure compilation engagements and year-end compilation engagements of entities not in the manufacturing, hospitality, and retail industries.
- Initial engagements for any new clients.
- All other types of engagements performed for the first time.
- **All Acquired Firm employee benefit plan and construction contractor audits.**
- **All other Acquired Firm engagements performed for the first time.**
- Other engagements at the discretion of the managing partner.

Establishing Qualifications for Appointment and Replacement of Engagement Quality Control Reviewers

QC 10.42 indicates that firms should establish policies and procedures to address the appointment of engagement quality control reviewers and to establish their eligibility through—

- a. the technical qualifications required to perform the role, including the necessary experience and authority, and
- b. the degree to which an engagement quality control reviewer can be consulted during an engagement without jeopardizing the reviewer's objectivity.

Technical Qualifications. The firm's policies and procedures on the technical qualifications of engagement quality control reviewers may address the experience, technical expertise, and authority needed to fulfill the role. What represents sufficient and appropriate experience, technical expertise, and authority depends on the circumstances of the engagement. For example, when determining the engagement quality control reviewer for an audit of a construction contractor client, an appropriate choice would be an individual who has technical expertise and experience with the construction industry. Alternatively, if an engagement quality control reviewer is needed for a first-time review of a new manufacturing client, the individual chosen needs technical expertise and experience in the

manufacturing industry as well as knowledge of issues that commonly occur when performing the initial review of any client.

Objectivity. QC 10.43 stipulates that the firm should establish policies and procedures designed to maintain the objectivity of the engagement quality control reviewer. Accordingly, while the engagement quality control reviewer is not a member of the engagement team, the engagement quality control reviewer should satisfy the independence requirements relating to the engagements reviewed. Such policies and procedures should provide that the engagement quality control reviewer—

- Is not selected by the engagement partner (when practicable).
- Does not otherwise participate in the performance of the engagement during the period of the EQCR.
- Does not make decisions for the engagement team.
- Is not subject to other considerations that would threaten the reviewer's objectivity.

The following paragraphs discuss these matters in further detail.

Not Selected by Engagement Partner. To maintain the objectivity of the engagement quality control reviewer, the firm's policies and procedures may include a requirement that the engagement quality control reviewer is not selected by the engagement partner. For example, larger firms may establish a QC procedure that the engagement quality control reviewer is selected by the director of quality control or the managing partner. However, for firms with few partners, it may not be practical for the engagement partner not to be involved in selecting the engagement quality control reviewer.

No Participation in Engagement Performance Other than Consultation. To maintain the objectivity of the engagement quality control reviewer, the firm's policies and procedures should include a requirement that the reviewer not participate in the performance of the engagement during the period of the EQCR except in a consulting role. QC 10.A49 explains that the engagement partner may consult the engagement quality control reviewer at any time during the engagement, for example, to establish that a judgment made by the engagement partner will be acceptable to the engagement quality control reviewer. This type of consultation may facilitate avoiding differences of opinion at a late stage in the engagement and does not necessarily impair the engagement quality control reviewer's eligibility to perform his or her role. However, if the nature and extent of the consultations become significant, the reviewer's objectivity may become impaired unless both the engagement team and the reviewer are careful to maintain the reviewer's objectivity. When it is not possible to maintain the reviewer's objectivity, another individual within the firm or a suitably qualified external person should be designated to take on the role of the engagement quality control reviewer.

No Engagement Team Decisions. To maintain the objectivity of the engagement quality control reviewer, the firm's policies and procedures should include a requirement that the engagement quality control reviewer not make decisions for the engagement team. Otherwise, the reviewer's objectivity on the engagement is threatened.

Not Subject to Other Considerations That Would Threaten the Reviewer's Objectivity. Policies and procedures designed to maintain the engagement quality control reviewer's objectivity should provide that the engagement quality control reviewer is not subject to other considerations that would threaten the reviewer's objectivity. In all circumstances associated with the role of engagement quality control reviewer, the person performing the EQCR should maintain his or her objectivity.

Replacement of Reviewers. Despite a firm's best efforts, or through inadvertent actions, situations may occur in which the engagement quality control reviewer is unable to maintain his or his objectivity. Accordingly, QC 10.44 indicates that the firm's policies and procedures should include a provision for the replacement of the engagement quality control reviewer when the reviewer's ability to perform an objective review is likely to have been impaired. For example, if the relative positions in the firm of the engagement partner and the engagement quality control reviewer keep the engagement quality control reviewer from maintaining their objectivity in carrying out his or her responsibilities, then a different engagement quality control reviewer needs to be selected. In such a situation, the firm may determine the relationships that create those objectivity issues and assign engagement quality control reviewers differently.

Contracting Engagement Quality Control Review. Sole practitioners and small firms may be especially challenged to identify a qualified individual within the firm to perform EQCRs. In such cases, QC 10.A50 indicates that suitably qualified external individuals or firms may be contracted with to perform the function. When the firm contracts with suitably qualified external individuals or other firms, the requirements discussed in the “Objectivity” and the “Replacement of Reviewers” paragraphs above should be followed. [QC 10.13 defines a *suitably qualified external person* as an individual outside the firm who possesses the competence and capabilities to act as an engagement partner (for example, a partner of another firm).] The AICPA's list of peer reviewers or the firm's state society may be resources for finding an engagement quality control reviewer.

Auditing Guidance Related to Governmental Entities. AU-C 220.A32 provides considerations specific to governmental entities. Firms that perform audits of governmental entities may have a statutorily appointed auditor who acts in the capacity of an engagement partner with overall responsibility for governmental audits. In such a situation, the selection of an engagement quality control reviewer includes consideration of the need for independence from the audited entity and the ability of the engagement quality control reviewer to provide an objective evaluation.

Documenting Engagement Quality Control Review

QC 10.45 indicates that firms should establish policies and procedures for documenting the engagement quality control review, including documentation that reflects that—

- The procedures required by firm policies have been performed.
- The review has been completed before the report is released.
- The reviewer is not aware of any unresolved matters that would cause him or her to believe that significant judgments the engagement team made and conclusions they reached were not appropriate.

Audit Requirements. With regard to documenting engagement quality control review for an audit engagement, AU-C 220.26 provides the same requirements listed above, adding that the date the EQCR was completed should also be documented, and the EQCR documentation should be prepared by the engagement quality control reviewer. Additionally, AU-C 220.A24 explains that, although the EQCR is required to be performed before the report is released, *documentation* of the EQCR may be completed after the report release date as part of the assembly of the final audit file.

MAINTAINING APPROPRIATE ENGAGEMENT DOCUMENTATION

As discussed at the beginning of this lesson, the engagement performance QC element provides guidance for more than merely general engagement performance. The information in this section addresses maintaining appropriate engagement documentation. The related QC requirements under QC 10 are presented in Exhibit 2-13. Exhibit 2-14 presents the attestation engagement-level QC requirements under AT-C 105 that oversee maintaining engagement documentation. Exhibit 2-15 presents an engagement-level QC requirement under AR-C 60 on engagement documentation for SSARS engagements. For audit engagements, AU-C 220 does not provide specific requirements related to maintaining engagement documentation because such guidance is provided in AU-C 230, *Audit Documentation*, as discussed below.

Exhibit 2-13**Requirements for Engagement Documentation
QC Policies and Procedures under QC 10**

Requirements	QC 10
Completion of the Assembly of Final Engagement Files	
The firm should establish QC policies and procedures that require engagement teams to complete the assembly of final engagement files on a timely basis after the release of the engagement reports.	QC 10.49
Confidentiality, Safe Custody, Integrity, Accessibility, and Retrievability of Engagement Documentation	
The firm should establish policies and procedures to ensure the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation is maintained.	QC 10.50
Retention of Engagement Documentation	
The firm should establish policies and procedures for engagement documentation retention for a period of time sufficient to meet the needs of the firm, professional standards, laws, and regulations.	QC 10.51

Exhibit 2-14**Attestation Engagement-level QC Requirement under AT-C 105**

Requirement	AT-C 105
The engagement partner should be responsible that appropriate documentation is maintained to provide evidence that the practitioner's objectives are achieved and that the engagement is performed in accordance with the attestation standards and relevant legal and regulatory requirements.	AT-C 105.35(d)

Exhibit 2-15**SSARS Engagement-level QC Requirement under AR-C 60**

Requirement	AR-C 60
In an engagement performed under SSARS, the engagement partner should take responsibility that appropriate engagement documentation is maintained.	AR-C 60.21(d)(iii)

Assembly of Engagement Documentation

QC 10.49 specifies that firms establish policies and procedures that require engagement teams to complete the assembly of final engagement files on a timely basis after the engagement reports have been released. Time limits for completing the assembly of final engagement files may be prescribed by professional standards, laws, or

regulations. When no such time limits are prescribed, the firm is required to establish time limits that reflect the need to complete the assembly of final engagement files on a timely basis. When performing an audit, for example, AU-C 230, requires that the final assembly and completion of the audit file should occur within 60 days of the report release date. Firms may adopt documentation completion periods that are shorter than 60 days, either on an engagement-by-engagement basis, or as part of the firm's quality control policies and procedures.

Additionally, when more than one report is issued relating to the same subject matter information of an entity, the firm's policies and procedures with regard to time limits for the assembly of final engagement files apply to each report as if it were a separate engagement. Such a situation may occur, for example, when the firm issues an audit report on financial information prepared in accordance with GAAP and, at a subsequent date, an audit report on the same financial information prepared in accordance with a special purpose framework for regulatory purposes.

Timely completion of engagement documentation is important to ensure engagement quality. As a practical matter, firms that strive to prepare engagement documentation as the engagement progresses are more likely to avoid inadvertently omitting critical information or incorrectly recording aspects of the procedures that were completed or the evidence obtained. Additionally, striving to assemble and maintain engagement documentation as the engagement progresses serves to make assembly of the engagement documentation more efficient.

When considering engagement documentation, many firms establish policies that require consistent file organization and indexing. Such policies permit efficiencies, including easy identification of information within the file, convenience of access by all levels of file reviewers, and consistency of approach to completing the file by all members of the firm. From a quality control perspective, consistent file organization and indexing assists with the process of ensuring that required sign-offs and cross-referencing have been performed, as well as appropriate disposition of review notes. *PPC's Guide to Audits of Nonpublic Companies* provides detailed information on workpaper organization and arrangement, including a suggested approach for indexing workpapers. Additionally, *PPC's Guide to Managing an Accounting Practice* addresses designing a filing system and retaining engagement documentation for all types of engagements and administrative files.

Audit Requirements. AU-C 230 establishes requirements and restrictions for assembling and completing an audit engagement file and making changes to engagement documentation. As mentioned above, the final assembly and completion of the audit engagement file should ordinarily occur within 60 days of the auditor releasing the report to the client.

Assembling and completing the final audit file is an administrative process that does not involve performing new audit procedures or forming new conclusions. At any time prior to the *documentation completion date*, the auditor is permitted to make administrative changes to the workpapers to:

- Finalize the documentation and assemble the evidence that was obtained, discussed, and agreed upon by the audit team prior to the date of the auditor's report, including discarding to-do lists and superseded drafts, correcting typographical errors, and changing notes that reflect incomplete or preliminary thinking.
- Insert information that was received after the date of the auditor's report, such as replacing faxed copies of confirmations with originals.
- Perform routine file assembly procedures that might include sorting, cross-referencing, collating, and deleting or discarding superseded documentation.
- Sign off on file completion checklists relating to the file assembly process.

SSAE Requirements. AT-C 105.35(c) requires the engagement partner to take responsibility for review of the work performed in accordance with the firm's review policies and procedures and review engagement documentation on or before the date of the practitioner's report. According to AT-C 105.A64, the engagement partner may delegate part of the review responsibility to other members of the engagement team in accordance with the firm's system of quality control. AT-C 105.35(d) requires the engagement partner to ensure that appropriate engagement documentation is maintained that provides evidence of achievement of the practitioner's objectives and supports that the engagement was performed in accordance with the attestation standards and relevant legal and regulatory requirements. Those requirements are included within a list of responsibilities that the engagement partner assumes for the overall quality on each attestation engagement.

AT-C 105 establishes the documentation requirements for all engagements performed under the attestation standards, primarily addressing documentation creation and maintenance. The level of service guidance in AT-C section 200, provides additional documentation requirements for the level of service being performed (i.e., examination, review, etc.). The overall documentation requirements of AT-C 105.37–.44 address the following considerations:

- Timely preparation of engagement documentation.
- Assembly and completion of engagement documentation within 60 days of releasing the practitioner's report.
- Maintaining engagement documentation intact until the firm's retention period is satisfied.
- Amending engagement documentation after the documentation completion date requires explanation of—
 - the reasons the changes are necessary, and
 - when and by whom the changes were made and reviewed.
- The confidentiality of engagement documentation, and acknowledgement that engagement documentation is the property of the firm.
- Adopting procedures to prevent unauthorized access to engagement documentation.
- Justifying and documenting the practitioner's reasons for departing from a relevant, presumptively mandatory requirement, and documenting how alternative procedures performed were sufficient to achieve the intent of that requirement.

SSARS Requirements. AR-C 60.21(d)(iii) specifies that the engagement partner should take responsibility for ensuring that appropriate engagement documentation is maintained for all engagements performed under the SSARS. This requirement is included in a list of requirements directing the engagement partner to ensure that SSARS engagements are performed in accordance with the firm's quality control policies and procedures. Thus, the requirement is not specific or limited to only assembly of engagement documentation; it is more broad, encompassing engagement documentation in totality.

Retention of Engagement Documentation

QC 10.51 states that firms should establish policies and procedures for the retention of engagement documentation for a period of time that is sufficient to meet the needs of the firm, professional standards, laws, and regulations. QC 10.A61 indicates that the firm adopts procedures that enable the preceding requirement to be met during the retention period and includes procedures, for example, that—

- Enable the retrieval of and access to engagement documentation during the retention period (particularly in the case of electronic documentation), as the underlying technology may need to be upgraded or revised over time.
- Where necessary, provide a record of changes made to engagement documentation after the assembly process is complete.
- Allow suitably qualified external individuals (those providing EQCR or consultation services, for example) and peer reviewers to easily access and review necessary engagement documentation.

Various states have enacted legislation or regulations that address the retention of audit documentation and may require a stipulated retention period. In some cases, government agencies have specific record retention requirements that are made part of the contract for the specified engagement performance. Additionally, there may exist generally accepted retention periods in the absence of specific legal or regulatory requirements. In making engagement documentation retention decisions, firms consider their unique needs and often determine that retention periods need to vary with the nature of the engagements and firm circumstances. Firms ought to consider consulting their attorneys and liability insurance carriers when establishing their retention policies. It may be helpful for one individual in the firm to maintain a listing that specifies the period of time that engagement documentation will

be retained for each level of engagement service. Generally, that individual is the quality control director or the managing partner.

Recognizing the need for exceptions in extenuating circumstances is also important when documenting retention policies. Most notably, when engagement documentation is the subject of a subpoena, or contemplated or threatened subpoena or summons, no file or document destruction should occur until the related issues have been fully settled.

QC 10.A62 provides guidance relating to the ownership of engagement documentation indicating that engagement documentation is the property of the firm unless otherwise specified by law or regulation. The firm may choose to make portions of, or extracts from, engagement documentation available to its clients, as long as doing so does not undermine the validity of the work performed or the independence of the firm or its personnel.

Audit Requirements. Auditing standards include specific engagement documentation retention requirements. AU-C 230 indicates that the retention period for audit engagement documentation should not be shorter than five years from the report release date. In determining appropriate document retention periods for the firm's engagement documentation, the firm may consider the nature of the engagement and the firm's unique circumstances.

Confidentiality, Custody, Integrity, Accessibility, and Retrievability of Engagement Documentation

QC 10.50 indicates that firms should establish policies and procedures that are designed to provide for the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation.

Confidentiality. The need to provide for a confidential relationship with a client is expressed in the *Confidential Client Information Rule* of the Code (ET 1.700.001), which states that members in public practice should not disclose any confidential client information without obtaining the client's specific consent. Ordinarily, engagement documentation can be shown outside of the firm only with the client's explicit permission. This is true even if a practitioner sells their practice to another firm, and it also applies to a predecessor communicating with a successor auditor. Specific laws or regulations may impose additional obligations on the firm to maintain client confidentiality, particularly when data of a personal nature are concerned.

There are some limited exceptions to engagement documentation confidentiality. For example, explicit client permission is not necessary for making engagement workpapers available if subpoenaed in connection with a legal proceeding, if requested in an ethical disciplinary proceeding, or if submitted in an AICPA or state CPA society authorized quality or peer review program. Also, *Disclosing Client Information During Litigation* (ET 1.700.070), clarifies the firm's responsibility when providing confidential client information to the firm's professional liability insurance carrier; the firm is not required to obtain a client's permission if the information is provided solely to assist in the defense against an actual or potential claim against the firm.

Audit Requirements. In addition to the QC 10 requirement to maintain confidentiality of engagement documentation, AU-C 230.19 requires the auditor to adopt reasonable procedures to maintain the confidentiality of client information.

Custody, Integrity, Accessibility, and Retrievability. Engagement documentation may exist on paper, electronically, or in some other media. Regardless of how it exists, the integrity, accessibility, and retrievability of the underlying data may be compromised if the documentation could be altered, added to, or deleted without the firm's knowledge. Accordingly, controls are necessary to prevent engagement documentation from unauthorized use or alteration, or from becoming lost or damaged. QC 10.A56 indicates that controls over engagement documentation to avoid unauthorized alteration or loss may include controls that enable the firm to—

- Determine when and by whom engagement documentation was prepared and reviewed.
- Protect the integrity of information at all stages of the engagement, especially when information is shared within the engagement team or transmitted to other parties via electronic means.
- Prevent unauthorized changes to engagement documentation.
- Allow access to engagement documentation by the engagement team and other authorized parties as necessary to properly discharge their responsibilities, and restrict access by others.

Additional controls that firms design and implement to maintain the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation may include controls such as the following:

- The use of data encryption and passwords by engagement team members to restrict access to electronic engagement documentation to authorized users.
- Back-up routines for electronic engagement documentation at appropriate stages during the engagement.
- Procedures to maintain engagement documentation in a central location to enhance retrievability (although back-up files would be maintained elsewhere).
- Procedures for distributing engagement documentation to the team members at the beginning of the engagement, processing it during the engagement, and collating it at the end of the engagement.
- Procedures to restrict access to, and enable proper distribution and confidential storage of, engagement documentation.

Audit Requirements. AU-C 230.17 states that the auditor should not delete or discard audit documentation before the end of the firm's specified retention period. However, if the auditor needs to modify existing audit documentation or add new documentation after the document completion date, AU-C 230.18 indicates that the auditor should document the following, regardless of the nature of the modifications or additions:

- The reasons for making the changes.
- When and by whom the changes were made and reviewed.

In the rare circumstance that the auditor performs new or additional audit procedures or draws new conclusions after the date of the auditor's report, the audit documentation requirements are more rigorous. The auditor should document—

- The circumstances encountered.
- The new or additional procedures performed, evidence obtained, and conclusions reached, along with the effect on the auditor's report.
- When and by whom the resulting audit documentation changes were made and reviewed.

Electronic Engagement Documentation. Many firms use electronic engagement software. As a result, the firm's engagement software may create and store those electronic documents, or the firm may scan engagement documents or otherwise convert original paper documentation to another media for inclusion in the engagement files. When converting original paper documentation to an electronic media, QC 10.A58 indicates that the firm's procedures may include requiring engagement team members to—

- Generate scanned copies that reflect a complete copy of the document (such as both sides of two-sided documents) and capture manual signatures, cross-references, and annotations.
- Integrate the scanned copies into the electronic engagement files, including indexing and signing off on the scanned copies as necessary.
- Enable the scanned copies to be retrieved and printed as needed.

Even firms that primarily perform their engagements using electronic engagement software may have legal, regulatory, or other reasons to retain some original paper documentation. Accordingly, the QC policies and procedures over engagement documentation confidentiality, safe custody, integrity, accessibility, and retrievability may need to encompass hard copy documents as well. See *PPC's Guide to Managing an Accounting Practice* for a detailed discussion of electronic engagement documentation.

SELF-STUDY QUIZ

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

12. Policies and procedures about consultation should provide the firm reasonable assurance of which of the following?
 - a. No consultation takes place unless three engagement team members agree.
 - b. The information from the consultation is attributed to the firm in the workpapers.
 - c. There are sufficient resources to allow the consultation to take place.
 - d. The conclusions from the consultation are understood by the firm and the client.
13. Why is it important for a firm to have an up-to-date professional reference library?
 - a. It can help firms find resources for external consultations.
 - b. It will help firms embrace a paperless work environment.
 - c. It helps staff members obtain a surface-level understanding of issues.
 - d. It may allow staff members to resolve issues on their own.
14. Which of the following engagements is more likely to need a consultation?
 - a. An engagement with an unmodified report.
 - b. An engagement for a client with integrity.
 - c. An engagement in which there is material litigation.
 - d. An engagement involving routine, simple transactions.
15. Differences of opinion should be—
 - a. ignored.
 - b. hidden.
 - c. resolved unanimously.
 - d. identified early.
16. What is the term for the required process used, prior to the report's release, to provide an objective evaluation of significant judgments made by the engagement team and the conclusions reached in formulating the report?
 - a. Engagement quality control review (EQCR).
 - b. Peer review.
 - c. Pre-issuance review.
 - d. System review.

17. The following practitioners all work for Starkwell Accounting. Which one would be the most objective engagement quality control reviewer?
- a. Maria is a member of the engagement team.
 - b. Howard made at least one decision for the engagement team.
 - c. Virginia is the first choice of the engagement partner in charge of the engagement.
 - d. Tony performed a minor consultation late in the engagement.
18. A firm's quality control policies and procedures should do what in regards to the retention of engagement documentation?
- a. Establish a retention period of a minimum of twenty years for all engagement documentation.
 - b. Provide a record of changes made after the documentation is assembled.
 - c. Ensure that the technology used to retain the documentation stays the same over time.
 - d. Ensure the confidentiality of documentation by only allowing access to firm members.

SELF-STUDY ANSWERS

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

12. Policies and procedures about consultation should provide the firm reasonable assurance of which of the following? **(Page 50)**
- a. No consultation takes place unless three engagement team members agree. [This answer is incorrect. According to QC 10.37, the policies and procedures should provide reasonable assurance that appropriate consultation takes place (such as when dealing with difficult or contentious issues). There is no requirement for team member agreement.]
 - b. The information from the consultation is attributed to the firm in the workpapers. [This answer is incorrect. Per QC 10.37, the firm needs reasonable assurance that the nature and scope of consultations are documented and are agreed upon by both those seeking consultation and the individual consulted. Documenting the information from the individual consulted as coming from the firm would be inappropriate.]
 - c. **There are sufficient resources to allow the consultation to take place. [This answer is correct. QC 10.37 indicates that the firm should establish policies and procedures over consultation to provide the firm with reasonable assurance that, among other things, sufficient resources are available to enable appropriate consultation to take place.]**
 - d. The conclusions from the consultation are understood by the firm and the client. [This answer is incorrect. As discussed in QC 10.37, the firm needs reasonable assurance that the consultation conclusions reached are documented, understood by both the individual seeking consultation and the individual consulted (not the client), and implemented.]
13. Why is it important for a firm to have an up-to-date professional reference library? **(Page 50)**
- a. It can help firms find resources for external consultations. [This answer is incorrect. Having ready access to the information in this type of library may help minimize the need for some external consultation and resolve any potential differences of opinion.]
 - b. It will help firms embrace a paperless work environment. [This answer is incorrect. Professional reference libraries can be either in paper format or use electronic media. The library's focus is on issues other than paperless workflows, though the firm's library can be paperless if it chooses.]
 - c. It helps staff members obtain a surface-level understanding of issues. [This answer is incorrect. Doing research in an up-to-date professional reference library can help staff members get more in-depth knowledge and understanding of an issue. It provides a learning opportunity for individuals.]
 - d. **It may allow staff members to resolve issues on their own. [This answer is correct. Having appropriate research resources is one of the many important reasons that firms need to maintain an adequate and up-to-date professional reference library. Having adequate up-to-date reference technical reference materials may allow personnel to resolve some issues more efficiently without the involvement of supervisory personnel.]**
14. Which of the following engagements is more likely to need a consultation? **(Page 53)**
- a. An engagement with an unmodified report. [This answer is incorrect. Any engagement in which a modified or nonstandard report is likely would be more apt to need a consultation.]
 - b. An engagement for a client with integrity. [This answer is incorrect. When there are questions regarding the integrity of management, the need for a consultation is more likely.]
 - c. **An engagement in which there is material litigation. [This answer is correct. It is a best practice for a firm's quality control system to document a list of common situations that often indicate when consultation is needed. The list might include situations such as a probable going**

concern issue, an engagement involving material litigation, and the first application of a new or complex technical pronouncement.]

- d. An engagement involving routine, simple transactions. [This answer is incorrect. A consultation is more likely to be needed if the engagement involves industries with special accounting, auditing, or reporting requirements or accounting for complex or unusual transactions.]

15. Differences of opinion should be— **(Page 54)**

- a. ignored. [This answer is incorrect. QC 10.46–.48 state that firms should establish policies and procedures for dealing with and resolving differences of opinion, not ignoring them.]
- b. hidden. [This answer is incorrect. Per QC 10.46–.48, policies and procedures related to differences of opinion should require that conclusions be documented and implemented, not hidden.]
- c. resolved unanimously. [This answer is incorrect. According to QC 10.46–.48, the firm's policies and procedures for differences of opinion should enable engagement team members to document their disagreement (if any) with the conclusions reached after appropriate consultation has taken place. The resolution does not have to be unanimous.]
- d. **identified early.** [This answer is correct. QC 10.A51–.A52 explain that effective procedures encourage identification of differences of opinion at an early stage of the engagement.]

16. What is the term for the required process used, prior to the report's release, to provide an objective evaluation of significant judgments made by the engagement team and the conclusions reached in formulating the report? **(Page 57)**

- a. **Engagement quality control review (EQCR).** [This answer is correct. QC 10.38 requires the firm to establish criteria against which all engagements covered by the QC standard are to be evaluated to determine whether an EQCR should be performed. This type of review is defined as a process designed to provide an objective evaluation, before the report is released, of the significant judgments made by the engagement team and the conclusions the engagement team reached in formulating the report.]
- b. Peer review. [This answer is incorrect. This type of review is done outside the firm using guidance such as the PRPM. It is a different kind of review than the one described above.]
- c. Pre-issuance review. [This answer is incorrect. Pre-issuance reviews performed by an individual who is not part of the engagement team can provide a fresh look at the engagement, but such reviews are not required by QC 10 and do not use the specific process defined above.]
- d. System review. [This answer is incorrect. This type of review is different from the type requested in this question; however, not having the type of review described in this question could be considered a deficiency in a firm's system review.]

17. The following practitioners all work for Starkwell Accounting. Which one would be the most objective engagement quality control reviewer? **(Page 65)**

- a. Maria is a member of the engagement team. [This answer is incorrect. QC 10.43 stipulates that the firm should establish policies and procedures designed to maintain the objectivity of the engagement quality control reviewer. Accordingly, while the engagement quality control reviewer is not a member of the engagement team, he or she should satisfy the independence requirements relating to the engagements reviewed. Because she is on the engagement team, Maria would not be considered an objective engagement quality control reviewer.]
- b. Howard made at least one decision for the engagement team. [This answer is incorrect. To maintain the objectivity of the engagement quality control reviewer, the firm's policies and procedures should include a requirement that the engagement quality control reviewer not make decisions for the engagement team. Otherwise, the reviewer's objectivity on the engagement is threatened. Therefore, Howard should not be selected to perform EQCR on this engagement.]

- c. Virginia is the first choice of the engagement partner in charge of the engagement. [This answer is incorrect. To maintain the objectivity of the engagement quality control reviewer, the firm's policies and procedures may include a requirement that the engagement quality control reviewer is not selected by the engagement partner. Therefore, Virginia would not be the most objective choice in this situation.]
 - d. **Tony performed a minor consultation late in the engagement. [This answer is correct. To maintain the objectivity of the engagement quality control reviewer, the firm's policies and procedures should include a requirement that the reviewer not participate in the performance of the engagement during the period of the EQCR except in a consulting role. QC 10.A49 explains that the engagement partner may consult the engagement quality control reviewer at any time during the engagement. If the nature and extent of the consultations become significant, the reviewer's objectivity could be impaired if not carefully maintained by both the engagement quality control reviewer and the engagement partner; however, because of the minor nature of Tony's consultation, he can still serve as an objective engagement quality control reviewer in this scenario.]**
18. A firm's quality control policies and procedures should do what in regards to the retention of engagement documentation? **(Page 69)**
- a. Establish a retention period of a minimum of twenty years for all engagement documentation. [This answer is incorrect. QC 10.51 states that firms should establish policies and procedures for the retention of engagement documentation for a period of time that is sufficient to meet the needs of the firm, professional standards, laws, and regulations. There is not a universal requirement for the length of the retention period.]
 - b. **Provide a record of changes made after the documentation is assembled. [This answer is correct. QC 10.A61 indicates that the firm's procedures related to documentation retention should include, among others, that, where necessary, a record is provided of changes made to engagement documentation after the assembly process is complete.]**
 - c. Ensure that the technology used to retain the documentation stays the same over time. [This answer is incorrect. QC 10.A61 indicates that the policies and procedures should enable the retrieval of and access to engagement documentation during the retention period, as the underlying technology may need to be upgraded or revised over time.]
 - d. Ensure the confidentiality of documentation by only allowing access to firm members. [This answer is incorrect. Under QC 10.A61, the policies and procedures should allow suitably qualified external individuals and peer reviewers to easily access and review necessary engagement documentation.]

DRAFTING QUALITY CONTROL POLICIES AND PROCEDURES

For some of the elements of quality control, professional standards will contain considerations or requirements that need to 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 authoritative literature. The quality control requirements of the engagement performance element of QC 10, relevant requirements of the Code, and other authoritative accounting and auditing guidance were discussed earlier in this lesson.

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 tool 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, firms may wish to consider the illustrative examples found in the AICPA Practice Aid for designing the engagement performance element of the quality control system.

Exhibit 2-16 is based on a section from the 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 engagement performance quality control system. Example policies are in bold type, example procedures are in regular type, and potential suggested descriptions are in italics.

Exhibit 2-16

AICPA Illustrative Quality Control Policies and Procedures for Engagement Performance

1. **The firm uses quality control materials (QCM) (for example, an audit and accounting manual, standardized forms, checklists, templates, practice aids, tools, questionnaires, and the like) to assist with engagement performance. (See paragraph .35 of QC section 10.)**
 - The firm QC partner establishes procedures to ensure that, whether the firm develops its own QCM or obtains it from a third-party provider,
 - the material is reliable and suitable for the practice;
 - the QCM is up to date,
 - modifications to the package and to individual forms are appropriate; and
 - the forms being used are appropriate for the engagement.
2. **Planning for engagements meets professional, regulatory and the firm's requirements.**
 - The firm provides personnel with the firm's practice aids that prescribe the factors the engagement team should consider in the planning process and the extent of documentation of those considerations.
 - The firm trains personnel on the use of the firm's practice aids (audit and accounting manual, standardized forms, checklists, templates, practice aids, tools, questionnaires, and the like).
 - Planning considerations may vary depending on the size and complexity of the engagement. The firm follows the following procedures for planning engagements:
 - When the firm accepts an audit, review or attestation examination in an industry in which the firm's personnel do not have recent experience, the firm requires all senior members of the engagement team to take industry-specific CPE before planning procedures are performed.
 - The engagement partner accepts responsibility for planning the engagement.
 - Appropriate personnel are assigned responsibilities during the planning phase.

- The engagement partner, or personnel designated by the engagement partner, develops or updates background information on the client and the engagement.
 - Planning includes determination of whether the engagement meets the firm's criteria for performing an EQCR. If so, the person performing the EQCR reviews the planning in a timely manner.
 - If a specialist or consultant is utilized to provide the engagement team with the necessary competence, that person reviews the planning in a timely manner.
 - The engagement team prepares planning documentation that includes the following:
 - Proposed work programs tailored to the specific engagement.
 - Staffing requirements.
 - Whether there is a need for specialized knowledge and how that will be obtained (for example, from other practice offices or through consultation).
 - Consideration of the economic conditions affecting the client and its industry and their potential effect on the conduct of the engagement.
 - Consideration of risks, including fraud considerations, affecting the client and the engagement and how they may affect the procedures to be performed.
 - A budget that allocates sufficient time for the engagement to be performed in accordance with professional standards and the firm's quality control policies and procedures.
 - Approval of planning and of the proposed work program by the engagement partner before work to obtain engagement evidence begins.
3. **The engagement is performed, supervised, documented, and reported (or communicated) in accordance with the requirements of professional standards, applicable regulators, and the firm.**
- Each engagement is assigned an engagement partner who accepts ultimate responsibility for the engagement.
 - A written work program is used in each engagement.
 - Each engagement is required to be supervised by suitably experienced engagement team members. Engagement supervision includes the following:
 - Briefing the engagement team on the objectives of their work.
 - Tracking the progress of the engagement.
 - Considering the competence and capabilities of individual members of the engagement team, whether they have sufficient time to carry out their work, whether they understand their instructions, and whether the work is being carried out in accordance with the planned approach to the engagement.
 - Addressing significant findings and issues arising during the engagement, considering their significance, and modifying the planned approach appropriately.
 - Identifying matters for consultation or consideration by more experienced engagement team members during the engagement.
 - Engagement personnel prepare working papers that adhere to the firm's guidelines, applicable regulatory requirements and professional standards for the form and content of documentation of the work performed and conclusions reached.
 - Engagement documentation makes clear when and by whom engagement documentation was prepared and reviewed.

4. Qualified engagement team members review work performed by other team members on a timely basis. (See paragraph .36 of QC section 10.)

- The firm's methodology prescribes who on the engagement team reviews the work of other members of the engagement team.
- For each engagement, there is evidence of appropriate review of documentation of the work performed, conclusions reached, the financial statements, and the report.
- The firm prescribes the extent of review of the nature, timing and extent of procedures performed to have reasonable assurance that they are consistent with the approach described in the planning documentation. Exceptions are investigated and resolved.
- Engagement documentation is reviewed to determine whether the following have occurred:
 - The work has been performed in accordance with professional standards and applicable legal and regulatory requirements.
 - Significant findings and issues have been raised for further consideration.
 - Appropriate consultations have taken place and the resulting conclusions have been documented and implemented.
 - The nature, timing, and extent of the work performed is appropriate and without need for revision.
 - The work performed supports the conclusions reached and is appropriately documented.
 - The evidence obtained is sufficient and appropriate to support the report.
 - The objectives of the engagement procedures have been achieved.

5. Engagements as specified in the firm's methodology are reviewed by a person who is not a member of the engagement team before the reports or other communications are issued.

- The firm's methodology specifies which engagements require pre-issuance review by a person who is not a member of the engagement team and prescribes the extent of the pre-issuance review of the report and other communication, financial statements, and selected documentation of the work performed and conclusions reached. This includes—
 - assigning a reviewer with the appropriate qualifications and
 - prescribing the documentation that the reviewer must review for each level of service and permitting the reviewer to select additional documentation to review.

6. The firm establishes, documents and follows procedures when the firm uses external personnel, such as from other firms, for audit or accounting engagements.

- Those procedures address the following:
 - The form in which instructions are given to external personnel.
 - The extent to which their work is reviewed.

7. The firm has criteria for determining whether an EQCR should be performed, evaluates all engagements against the criteria, performs an EQCR for all engagements that meet the criteria, and completes the review before the report is released. (See paragraphs .38–.40 of QC section 10.)

- The firm's criteria for requiring that an EQCR be performed are based on the firm's assessment, given the structure and nature of the firm's practice, of which engagements would most benefit from an independent review.

- The firm's criteria include [*specify criteria, which could include, but are not limited to, the following*]:
 - The identification of unusual circumstances or risks in an engagement, or class of engagements, as pre-determined by the firm. For example,
 - audits in which a going concern issue was identified but the report was not modified;
 - a compilation with disclosures when the firm has only been doing compilations without disclosures; or
 - a review (or other engagement) for an entity with issues that the firm rarely encounters (for example, joint ventures).
 - An engagement quality control review is required by law or regulation.
 - An engagement for which the undue influence threat may exist (such as an engagement that represents more than 10 percent of the firm's audit and accounting practice).
 - A high-risk engagement, as defined by the firm, using the same criteria used for acceptance and continuance.
 - An engagement in an industry in which the firm's practice is limited and the firm's personnel have little or no experience.
 - An engagement for which the familiarity threat may exist.
 - An engagement for an entity operating in a highly specialized or regulated industry, including financial institutions and employee benefit plans, and audits in accordance with government auditing standards.
 - The firm evaluates all engagements against the criteria and performs an EQCR for all engagements that meet the criteria.
8. **Engagement quality control reviewers meet the firm's criteria for eligibility. (See paragraph .42 of QC section 10.)**
- Selection of the engagement quality control reviewer is not made by the engagement partner.
 - The engagement quality control reviewer meets the following criteria:
 - Has sufficient technical expertise and experience.
 - Carries out his or her responsibilities with objectivity and due professional care without regard to the relative positions of the audit engagement partner and the engagement quality control reviewer. If the reviewer's objectivity becomes impaired, the reviewer must be replaced.
 - Does not make decisions for the engagement team or participate in the performance of the engagement except to serve as a consultant to the engagement partner at any stage during the engagement, with the understanding that the engagement quality control reviewer's objectivity may be impaired if the nature and extent of consultations becomes significant.
 - Does not assume any of the responsibilities of the engagement partner or have responsibility for the audit of any significant subsidiaries, divisions, benefit plans, or affiliated or related entities.
 - Meets the independence requirements relating to the engagements reviewed, even though the engagement quality control reviewer is not a member of the engagement team.
 - When the firm does not have suitably qualified personnel to perform the EQCR, the firm contracts with a suitably qualified external person to perform the engagement quality control review.

9. The firm establishes procedures addressing the nature, timing, extent, and documentation of the EQCR. (See paragraph .40 of QC section 10.)

- Regarding the EQCR, the engagement partner understands and performs the following:
 - The engagement partner remains responsible for the engagement and its performance, and the engagement quality control reviewer does not make decisions for the engagement team.
 - The engagement partner may consult the engagement quality control reviewer at any stage during the engagement, with the understanding that the engagement quality control reviewer's objectivity may be impaired if the nature and extent of consultations becomes significant.
- For engagements that meet the firm's criteria for having an EQCR performed, the engagement partner—
 - determines that an engagement quality control reviewer has been appointed;
 - discusses with the engagement quality control reviewer the significant findings or issues that arose during the engagement, if any; and
 - does not release the report until the completion of the EQCR.
- Timing of the EQCR. Performing an EQCR is not necessary to obtain sufficient appropriate audit evidence for audit engagements; therefore, the EQCR does not need to be completed before the date of the auditor's report. When the EQCR results in additional audit procedures being performed, the date of the auditor's report is changed to the date by which sufficient appropriate audit evidence has been obtained.
- The firm's procedures require that for audit and examination engagements, the engagement quality control reviewer do the following: (See paragraph .41 of QC section 10.)
 - Discuss significant accounting, auditing, and financial reporting issues with the engagement partner, including matters for which there has been consultation.
 - Discuss with the engagement partner the engagement team's identification and audit of high-risk assertions, transactions and account balances.
 - Confirm with the engagement partner that there are no significant unresolved issues.
 - Review selected working papers relating to the significant judgments the engagement team made and the conclusions they reached.
 - Review documentation of the resolution of significant accounting, auditing or financial reporting issues, including documentation of consultation with firm personnel or external sources.
 - Review the summary of uncorrected misstatements related to known and likely misstatements.
 - Review additional engagement documentation to the extent considered necessary.
 - Read the financial statements and the report and consider whether the report is appropriate.
 - Complete the review before the release of the report.
 - Conduct the review at appropriate stages during the engagement to the extent possible.
 - Determine whether the issues raised in the review require additional procedures that necessitate changing the auditor's report date.
- Before reports are released, matters that would cause the reviewer to question the engagement team's judgments and conclusions are resolved and the resolution is documented.
- The EQCR is documented. Documentation includes the following: (See paragraph .45 of QC section 10.)

- That the procedures required by the firm's policies on EQCR have been performed.
 - That the EQCR has been completed before the report is released.
 - An assertion that the reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments the engagement team made and the conclusions it reached were not appropriate.
10. **The firm requires that consultation take place when appropriate; that sufficient and appropriate resources are available to enable appropriate consultation to take place; that all the relevant facts known to the engagement team are provided to those consulted; that the nature, scope, and conclusions of such consultations are documented; and that conclusions resulting from such consultations are implemented. (See paragraph .37 of QC section 10.)**
- The firm informs personnel of its consultation policies and procedures.
 - The firm identifies circumstances, including specialized situations, in which firm personnel are expected to consult. Those circumstances include the following [*specify the criteria*]:
 - *Application of newly issued technical pronouncements.*
 - *Industries with special accounting, auditing, or reporting requirements.*
 - *Emerging practice problems.*
 - *Choices among alternative generally accepted accounting principles upon initial adoption or when an accounting change is made.*
 - *Reissuance of a report, consideration of omitted procedures after a report has been issued or subsequent discovery of facts that existed at the time a report was issued.*
 - *Filing requirements of regulatory agencies.*
 - The firm has established criteria which require consultation with outside parties, such as other firms, the AICPA Technical Hotline (877.242.7212), AICPA Audit Quality Centers, AICPA Center for Plain English Accounting, other professional and regulatory bodies, and commercial organizations that provide relevant quality control services. Before using such services, the firm evaluates whether the external provider is qualified for that purpose.
 - The firm requires sufficiently experienced engagement team members to identify matters for consultation or consideration during the engagement.
 - The firm designates individuals within and outside the firm as consultants in certain areas. Such individuals have appropriate knowledge, authority and experience. A list is maintained of the individuals within and outside the firm that the firm has designated as consultants, along with the areas of their expertise.
 - The firm requires the engagement partner to determine the need to consult. That determination is based on the following:
 - The materiality of the matter.
 - The experience of senior engagement personnel in a particular industry or functional area.
 - Whether the financial reporting framework or professional standards applicable to the engagement are as follows:
 - Based on authoritative pronouncements that are subject to varying interpretations.
 - Based on varied interpretations of prevailing practice.
 - Under active consideration by an authoritative body.

- The firm maintains and provides its personnel access to adequate and current reference materials, including materials relevant to its clients. Those materials include the most current versions of the following:
 - AICPA Professional Standards.
 - AICPA Audit and Accounting guides relevant to all industries in which the firm practices.
 - FASB pronouncements.
 - Any other pronouncements relevant to the firm's practice (such as SEC pronouncements, GASB pronouncements, Government Auditing Standards, and other relevant government audit guides).
 - Those consulted are provided with all relevant facts that will enable them to provide informed advice.
 - The firm resolves differences of opinion between engagement personnel and specialists before report issuance.
 - The firm requires documentation of consultations. That required documentation includes the following:
 - All relevant facts and circumstances.
 - References to professional literature used in the determination.
 - Conclusions reached, and how they were implemented.
 - Signatures of engagement partner and consultant.
 - Reference to the engagement working papers.
11. **The firm addresses and resolves differences of opinion within the engagement team, with those consulted, and, when applicable, between the engagement partner and the engagement quality control reviewer. (See paragraph .46–.48 of QC section 10.)**
- The firm follows procedures for consultation in resolving differences within an engagement team. If further action is necessary, the engagement and the quality control partners, and the firm's leadership if necessary, resolve the differences.
 - The conclusion reached to resolve the matter of disagreement and how that conclusion was implemented are documented.
 - The firm will not release the report until any differences of opinion are resolved.
 - Any party to the consultation or difference of opinion who disagrees with the final conclusion may document his or her disagreement with, and disassociate themselves from, the resolution of the matter.
12. **Engagement teams complete the assembly of final engagement files on a timely basis. (See paragraph .49 of QC section 10.)**
- Final engagement files are assembled by the earlier of time limits required by professional standards and applicable regulatory requirements, if any, or 60 days from the report release date.
13. **The firm maintains the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation. (See paragraph .50 of QC section 10.)**
- The firm implements adequate and appropriate controls over the confidentiality, custody, integrity, accessibility, and retrievability of the firm's engagement documentation.
 - Adequate and appropriate controls over confidentiality, custody, integrity, accessibility, and retrievability of engagement documentation include the following:
 - Requiring that engagement documentation clearly indicates when and by whom it was prepared and reviewed.

- Procedures to protect the integrity of the information at all stages of the engagement, especially when the information is shared within the engagement team or transmitted to other parties via electronic means.
 - Procedures to prevent unauthorized changes to the engagement documentation. For electronic engagement documentation this includes
 - using passwords or data encryption, or both, to restrict access to authorized users, and
 - using appropriate back-up routines at appropriate stages during the engagement.
 - Procedures for tracking the distribution of engagement documentation materials to personnel at the start of the engagement, preparing engagement documentation during the engagement, and assembling final documentation at the end of the engagement.
 - Procedures to allow access to paper engagement documentation for the engagement team and other authorized users, and restrict access by others.
 - Maintaining engagement documentation in one location to enhance retrievability (this applies to both hardcopy and electronic documentation, although back-up files would be maintained elsewhere).
 - Implementing procedures regarding original paper documents that have been electronically scanned or otherwise copied to another media that accomplish the following:
 - Generate copies that contain the entire content of the original paper documentation, including manual signatures, cross-references, and annotations.
 - Integrate the copies into the engagement files, including indexing and signing off on the copies as necessary.
14. **The firm retains engagement documentation for a period of time sufficient to meet the needs of the firm, professional standards, laws, and regulations. (See paragraph .51 of QC section 10.)**
- The quality control partner maintains a list specifying the period of time sufficient to meet the needs of the firm, the requirements of the state board(s) of accountancy, and applicable professional standards, for each level of engagement service.
 - Engagement documentation is retained for the specified period of time.
-

While the AICPA's illustrative policies and procedures provide a logical starting point for designing the engagement performance quality control system, the firm should carefully consider its needs 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 the illustrated policies and procedures are only those a firm *may consider* establishing and implementing. 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. A review of the AICPA *Peer Review Program Manual* (PRPM) is especially important when designing the engagement performance QC system because this element receives close scrutiny during peer review. The extra attention given to this element occurs because the peer review team reviews the workpapers of selected engagements. The workpaper review subjects the engagement performance system to a thorough evaluation. A review of the PRPM is also helpful to enable an understanding of the consultation areas a peer reviewer will emphasize.

The PRPM contains checklists to review the performance of selected engagements to audit, review, compile, or prepare historical financial statements. It also includes checklists for the review of selected engagements to examine or compile prospective financial statements and for the review of various agreed-upon procedures and other attestation engagements. Also included in the PRPM are checklists for the review of audits of government entities,

not-for-profits, and employee benefit plans. AICPA members can access those checklists at us.aicpa.org/InterestAreas/PeerReview/Community/PeerReviewers by clicking on the “Team and Review Captain Checklists” link.

Peer Reviewers Evaluate Firm QC System Design. During the planning phase of a firm's peer review, the peer reviewer completes a questionnaire to evaluate the design of the firm's quality control policies and procedures. The questionnaire concentrates on the QC 10 requirements for each element of quality control, but also considers the related application guidance. Reviewers consider if a firm's documented quality control policies and procedures do not address the guidance in QC 10 because such a situation may indicate that the firm's system of quality control could be out of compliance with professional standards. Firms may access those same questionnaires in the PRPM; section 4600 of the PRPM presents the questionnaire for firms with two or more personnel, and section 4500 of the PRPM presents the questionnaire for a sole practitioner with no personnel. This course recommends that practitioners involved in designing and maintaining the firm's QC system for engagement performance read the 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 also available on the AICPA's Enhancing Audit Quality Initiative resources web page at us.aicpa.org/interestareas/privatecompaniespracticesection/qualityservicesdelivery/keepingup/invigorate-the-focus, beneath the “Quality Control & Peer Review” heading. Access to the questionnaires is restricted to AICPA members.

Developing Policies and Procedures for Engagement Performance

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 size of the firm, the number of firm locations, operating characteristics of the firm, the knowledge and experience of firm personnel, and the nature and complexity of the firm's practice, including whether it is part of a network, can impact the QC policies and procedures for a given firm.

There is more than one way to develop a firm's quality control policies and procedures. For example, this course chose to develop one policy statement for each QC element or major section and then design 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.

Developing Engagement Level Quality Control Steps

As noted earlier in this lesson, developing the actual engagement performance quality control system is a difficult task. Referring back to the “Designing an Engagement Performance QC System” discussion earlier in this lesson, the following considerations may enter into the design of the procedures:

- The procedures should cover all types of accounting and assurance engagements performed by the firm (audit, attestation, and SSARS).
- Procedures from other QC elements should be incorporated into the procedures.
- The procedures should interface with the accounting and auditing materials (also known as *quality control materials* or QCM) used by the firm.
- The procedures should be flexible and reasonable, in relation to the firm's size and number of employees.

The challenge comes in determining how to incorporate the preceding considerations, the AICPA illustrative procedures in Exhibit 2-16, and the requirements of QC 10 into a concise, organized format. There are several approaches, each of which is discussed in the following paragraphs.

Presenting the Detailed Procedures in the Body of the QC Document. Some firms choose to include in the body of their engagement performance QC procedures every quality control step the firm follows on a typical engagement.

Such a format, while comprehensive, tends to be lengthy and difficult to understand because the nuances of each type of engagement (audit, attestation, and SSARS) are difficult to capture in a concise narrative.

Referencing to Engagement Procedures Located in the Firm's Accounting and Auditing Materials. Another widely used approach is to make reference in the QC document to the engagement procedures and checklists located in the accounting and auditing materials used by the firm. This approach avoids the problem of incorporating the numerous procedures into the QC document; however, it has one disadvantage—rarely does a firm follow every procedure in its audit and accounting materials verbatim (especially if purchased from a third party).

Building a Bridging Document. A compromise to the two previously discussed approaches is to build a bridging document. A *bridging document* is the term used by this course to describe a worksheet that shows the engagement performance QC steps performed by the firm for each type of engagement. Such a worksheet allows the firm to tailor its procedures to fit the type of engagement and to interface its QC document into the checklists, forms, and practice aids used by the firm. (Such practice aids may be those adopted from purchased accounting and auditing materials, those designed by the firm, or a combination of both.) Exhibit 2-17 illustrates a bridging document for audits. Exhibit 2-18 illustrates a bridging document for attestation engagements. Exhibit 2-19 illustrates a bridging document for SSARS engagements. The paragraphs following the exhibits provide further information on the use of bridging documents.

Exhibit 2-17

Illustration of an Engagement Performance Bridging Document (Audit Engagements)

Engagement Performance Quality Control Steps	Person or Group Responsible for Completing Step		Historical Financial Statements ^a	
	Primary Responsibility	Secondary Responsibility	Audits	Audits under AU-C 940 (ICFR)
1. Evaluate whether to accept/continue the engagement, considering ethical requirements (including if nonattest services create an independence threat); the client's integrity; and the firm's competence, capabilities, time, and resources.	Partner (P)	Engagement Team (ET)	Yes	Yes
2. Obtain a signed engagement letter.	P	ET	Yes	Yes
3. Assign staff based on competence, capabilities, and availability.	P	ET	Yes	Yes
4. Develop a preliminary audit strategy, including consideration of more than one component, use of specialists, and/or service organizations.	ET	P	Yes	Yes
5. Determine and document planning materiality and performance materiality.	ET	P	Yes	Yes
6. Hold an engagement team discussion about the susceptibility of the financial statements to material misstatement due to error or fraud.	P	ET	Yes	Yes
7. Perform preliminary analytical procedures.	ET	P	Yes	Yes
8. Inquire of management and perform other risk identification and assessment procedures to obtain an understanding of the entity and its environment, including internal control.	ET	P	Yes	Yes
9. Identify and assess risks of material misstatement (including fraud risks) at the financial statement level and relevant assertion level and design responses to identified risks.	ET	P	Yes	Yes
10. Prepare an audit plan.	ET	P	Yes	Yes
11. Develop a time estimate.	ET	P	Opt	Opt

Engagement Performance Quality Control Steps	Person or Group Responsible for Completing Step		Historical Financial Statements ^a	
	Primary Responsibility	Secondary Responsibility	Audits	Audits under AU-C 940 (ICFR)
12. Obtain partner approval of audit plan and staff assignments, and, if applicable, time estimates.	P	ET	Yes	Yes
13. Test, evaluate, and document design and operating effectiveness of internal control.	ET	P	Opt	Yes
14. Perform and document further audit procedures.	ET	P	Yes	Yes
15. Supervise procedures (including work of other auditors).	ET	P	Yes	Yes
16. Obtain legal representation letters.	ET	P	Yes	Yes
17. Summarize, evaluate, and conclude on the effect of accumulated misstatements.	P	ET	Yes	Yes
18. Perform final analytical review.	ET	P	Yes	Yes
19. Complete a presentation and disclosure checklist and read the financial statements.	ET	P	Yes	Yes
20. Obtain a management representation letter.	ET	P	Yes	Yes
21. Evaluate management's report on internal control for completeness and propriety.	ET	P	No	Yes
22. Draft the report(s).	ET	P	Yes	Yes
23. Consider and document changes from the audit strategy, planning materiality, or audit plan.	ET	P	Yes	Yes
24. Review the workpapers and determine and document the sufficiency and appropriateness of the audit evidence obtained.	P & ET	—	Yes	Yes
25. Determine that all review points and open items have been cleared.	ET	P	Yes	Yes
26. Obtain an engagement quality control review, if required by firm policy.	P	ET	Yes	Yes
27. Obtain consultation when appropriate and document and implement conclusions.	P	ET	Yes	Yes
28. Resolve any differences of opinion and document and implement conclusions.	P	ET	Yes	Yes
29. Determine that all quality control engagement-level procedures have been performed.	P	ET	Yes	Yes
30. Prepare required client communications.	ET	P	Yes	Yes
31. Have the partner approve and sign the report or transmittal letter.	P	ET	Yes	Yes
32. Evaluate the staff's performance.	ET	P	Opt	Opt
33. Maintain the confidentiality, safe custody, integrity, accessibility, and retrievability of the workpapers.	ET	P	Yes	Yes
34. Assemble and retain the workpapers for a sufficient period of time (subject to monitoring review).	ET	P	Yes	Yes

Note:

^a Opt—Optional.

Exhibit 2-18

Illustration of an Engagement Performance Bridging Document (Attestation Engagements)

	Person or Group Responsible for Completing Step		Type of Engagement ^{a, b}						
			Forecasts and Projections		Other Attestations			SOC 1	SOC 2
Engagement Performance Quality Control Steps	Primary Responsibility	Secondary Responsibility	Examinations	Agreed-upon Procedures	Reviews	Examinations	Agreed-upon Procedures	Examinations	Examinations
1. Evaluate whether to accept/continue the engagement, considering ethical requirements (including if nonattest services create an independence threat); the client's integrity; and the firm's competence, capabilities, time, and resources.	Partner (P)	Engagement Team (ET)	Yes	Yes	Yes	Yes	Yes	Yes	Yes
2. Obtain a signed engagement letter.	P	ET	Yes	Yes	Yes	Yes	Yes	Yes	Yes
3. Request a written assertion.	P	ET	Yes	Opt ^c	Yes	Yes ^d	Opt ^c	Yes	Yes
4. Assign staff based on competence, capabilities, and availability.	P	ET	Yes	Yes	Yes	Yes	Yes	Yes	Yes
5. Evaluate the propriety of a change in engagement scope or step down to a lower level of service.	ET	P	Yes	Opt	Yes	Yes	N/A	Yes	Yes
6. Plan the work, including the involvement of others, and obtain an understanding of the subject matter and the engagement.	ET	P	Yes	Yes	Yes	Yes	Yes	Yes	Yes
7. Evaluate and document materiality.	ET	P	Yes	No	Yes	Yes	No	Yes	Yes
8. Consider potential fraud implications.	ET	P	Yes	Yes	Yes	Yes	Yes	Yes	Yes
9. Identify and assess risks of material misstatement and develop responses to identified risks.	ET	P	Yes	No	Opt	Yes	No	Yes	Yes
10. Prepare an engagement strategy (examinations and reviews only) and an engagement plan.	ET	P	Yes	Yes	Yes	Yes	Yes	Yes	Yes
11. Develop a time estimate.	ET	P	Opt	Opt	Opt	Opt	Opt	Opt	Opt
12. Obtain partner approval of engagement plan and staff assignments, and, if applicable, time estimates.	P	ET	Yes	Yes	Yes	Yes	Yes	Yes	Yes
13. Perform and document the procedures.	ET	P	Yes	Yes	Yes	Yes	Yes	Yes	Yes
14. Supervise procedures (including work of others).	ET	P	Yes	Yes	Yes	Yes	Yes	Yes	Yes
15. Draft (or assist in drafting) the financial information or subject matter.	ET	P	Opt	Opt	Opt	Opt	Opt	Opt	Opt
16. Perform analytical procedures.	ET	P	Opt	No	Yes	Opt	No	No	No
17. Complete a presentation and disclosure checklist and read the financial information.	ET	P	Yes	Opt	N/A	N/A	N/A	N/A	N/A
18. Obtain a description of the system of internal control.	P	ET	No	No	No	No	No	Yes	Yes
19. Request the required representation letter(s).	ET	P	Yes	Yes	Yes	Yes	Yes	Yes	Yes

	Person or Group Responsible for Completing Step		Type of Engagement ^{a, b}						
			Forecasts and Projections		Other Attestations			SOC 1	SOC 2
Engagement Performance Quality Control Steps	Primary Responsibility	Secondary Responsibility	Examinations	Agreed-upon Procedures	Reviews	Examinations	Agreed-upon Procedures	Examinations	Examinations
20. Draft the report.	ET	P	Yes	Yes	Yes	Yes	Yes	Yes	Yes
21. Review the workpapers.	P & ET	—	Yes	Yes	Yes	Yes	Yes	Yes	Yes
22. Determine that all review points and open items have been cleared.	ET	P	Yes	Yes	Yes	Yes	Yes	Yes	Yes
23. Obtain an engagement quality control review, if required by firm policy.	P	ET	Yes	Yes	Yes	Yes	Yes	Yes	Yes
24. Obtain consultation when appropriate and document and implement conclusions.	P	ET	Yes	Yes	Yes	Yes	Yes	Yes	Yes
25. Resolve any differences of opinion and document and implement conclusions.	P	ET	Yes	Yes	Yes	Yes	Yes	Yes	Yes
26. Have the partner approve and sign the report or transmittal letter.	P	ET	Yes	Yes	Yes	Yes	Yes	Yes	Yes
27. Evaluate the staff's performance.	ET	P	Opt	Opt	Opt	Opt	Opt	Opt	Opt
28. Maintain the confidentiality, safe custody, integrity, accessibility, and retrievability of the workpapers.	ET	P	Yes	Yes	Yes	Yes	Yes	Yes	Yes
29. Assemble and retain the workpapers for a sufficient period of time (subject to monitoring review).	ET	P	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Notes:

- ^a Opt—Optional.
- ^b In September 2020, the Auditing Standards Board (ASB) issued SSAE No. 21, *Direct Examination Engagements*, to create a new service under the attestation standards—direct examinations—in which the practitioner measures or evaluates the responsible party's subject matter and examines it. This new type of service does not apply to engagements to examine prospective financial information, nor to examinations of service organization reports. Under SSAE No. 21, there are two types of examinations: assertion-based examinations and direct examinations. Additionally, in December 2020, the ASB issued SSAE No. 22, *Review Engagements*, to conform certain concepts in AT-C 210 with similar concepts in AT-C 205, which was necessary following the issuance of SSAE No. 21. SSAE Nos. 21–22 are effective for reports dated on or after June 15, 2022. The changes under new SSAE Nos. 21–22 have been considered in this bridging document.
- ^c SSAE No. 19, *Agreed-Upon Procedures Engagements*, among other things, allows the practitioner to report on the subject matter in an agreed-upon procedures engagement without obtaining a written assertion that the subject matter complies with the underlying criteria from the party responsible for the subject matter. Accordingly, requesting such a written assertion is optional.
- ^d Prior to implementing SSAE No. 21, a written assertion is required when performing examination engagements. After implementing SSAE No. 21, a written assertion is required only when performing an assertion-based examination engagement. SSAE No. 21, *Direct Examination Engagements*, is effective for reports dated on or

after June 15, 2022, with early implementation permitted as long as the related amendments made to AT-C 105 are also implemented early.

Exhibit 2-19

Illustration of an Engagement Performance Bridging Document (SSARS Engagements)

Engagement Performance Quality Control Steps	Person or Group Responsible for Completing Step		Preparations ^a	Compilations ^a	Reviews ^a
	Primary Responsibility	Secondary Responsibility			
1. Evaluate whether to accept/continue the engagement, considering ethical requirements (including if nonattest services create an independence threat); the client's integrity; and the firm's competence, capabilities, time, and resources.	Partner (P)	Engagement Team (ET)	Yes	Yes	Yes
2. Obtain a signed engagement letter.	P	ET	Yes	Yes	Yes
3. Assign staff based on competence, capabilities, and availability.	P	ET	Yes	Yes	Yes
4. Evaluate the propriety of a step down to a lower level of service.	P	ET	No	Yes ^b	Yes
5. Determine materiality for the financial statements as a whole. ^c	ET	P	Opt	Opt	Yes ^c
6. Obtain an understanding of the entity's financial reporting framework and significant accounting policies.	ET	P	Yes	Yes	Yes
7. Consider potential fraud implications.	ET	P	Yes	Yes	Yes
8. Prepare an engagement plan.	ET	P	Yes	Yes	Yes
9. Develop a time estimate.	ET	P	Opt	Opt	Opt
10. Obtain partner approval of engagement plan and staff assignments, and, if applicable, time estimates.	P	ET	Yes	Yes	Yes
11. Perform and document the procedures.	ET	P	Yes	Yes	Yes
12. Supervise procedures (including work of other accountants, for reviews only). ^d	ET	P	Yes	Yes	Yes ^d
13. Draft (or assist in drafting) the financial statements/financial information.	ET	P	Yes	Yes	Yes
14. Complete a presentation and disclosure checklist (if applicable) and read the financial statements/financial information.	ET	P	Yes	Yes	Yes
15. Obtain a management representation letter.	ET	P	Opt	Opt	Yes
16. Draft the report.	ET	P	No	Yes	Yes
17. Review the workpapers.	P & ET	—	Yes	Yes	Yes
18. If information is incorrect, incomplete, or otherwise unsatisfactory, obtain revised information/perform additional procedures.	ET	P	Yes	Yes	Yes
19. Determine that all review points and open items have been cleared.	ET	P	Yes	Yes	Yes

Engagement Performance Quality Control Steps	Person or Group Responsible for Completing Step		Preparations ^a	Compilations ^a	Reviews ^a
	Primary Responsibility	Secondary Responsibility			
20. Obtain an engagement quality control review, if required by firm policy.	P	ET	Yes	Yes	Yes
21. Obtain consultation when appropriate and document and implement conclusions.	P	ET	Yes	Yes	Yes
22. Resolve any differences of opinion and document and implement conclusions.	P	ET	Yes	Yes	Yes
23. Have the partner approve and sign the report.	P	ET	No	Yes	Yes
24. Evaluate the staff's performance.	ET	P	Opt	Opt	Opt
25. Maintain the confidentiality, safe custody, integrity, accessibility, and retrievability of the workpapers.	ET	P	Yes	Yes	Yes
26. Assemble and retain the workpapers for a sufficient period of time (subject to monitoring review).	ET	P	Yes	Yes	Yes

Notes:

- ^a Opt—Optional.
- ^b N/A when performing a compilation engagement for pro forma financial information because a lower level of service does not exist in that circumstance.
- ^c AR-C 90.19 adds an explicit requirement for the accountant to determine materiality for the financial statements as a whole and apply materiality in designing procedures and evaluating the results of the procedures performed. Further, the accountant is required to revise materiality if the accountant becomes aware of information that would have resulted in a different initial materiality amount (AR-C 90.20).
- ^d AR-C 90.39 broadens the term *others*. The discussion indicates that *others* includes not only other accountants, but also individuals (or organizations) having expertise beyond that of financial reporting. The guidance explicitly requires the accountant to ensure that the work performed by others is adequate for the accountant's purposes.

Interfacing the Bridging Document with the Firm's Accounting and Auditing Materials. Rarely does a firm follow every procedure in its accounting and auditing materials verbatim (especially if purchased from a third party). For firms that adapt accounting and auditing materials developed by a third party into its practice, this course offers the following paragraph which can be added to the engagement performance section of a firm's QC document. (In the following illustration, the firm uses the Thomson Reuters PPC brand engagement materials.)

After evaluating the reliability and suitability of PPC accounting and auditing materials, the firm adopts and integrates within its quality control system the use of such materials as more fully described in the attached engagement performance bridging documents. This QC document, the PPC materials, and any other materials used by the firm are intended solely to assist us in achieving compliance with professional standards. Accordingly, nothing within this QC document should be construed as (a) requiring a higher level of performance or documentation than the minimum specifically required by our firm's QC policies and procedures, or (b) overriding the exercise of professional judgment.

This additional paragraph, along with an engagement performance bridging document, may allow a firm to tailor its procedures to fit each type of engagement and to interface its QC document into the checklists, forms, and practice aids used by the firm.

Documenting the Quality Control Steps in the Bridging Document. As illustrated in Exhibits 2-17, 2-18, and 2-19, this course has established specific steps in the engagement performance QC system. These steps may be necessary for firms, regardless of size, to enable them to:

- Comply with the engagement performance requirements of the authoritative literature.
- Meet peer review requirements.
- Interface the firm's engagement performance QC system into the QC procedures found in the other elements of the QC system (see Exhibit 2-5).

While this course suggests that these are the minimum steps necessary for a QC engagement performance system, some firms may desire a more comprehensive system and, accordingly, may choose to expand the steps in Exhibits 2-17, 2-18, or 2-19 to provide greater detail and/or more engagement performance steps.

Additionally, this course recommends the use of bridging documents, practice aids, and monitoring memoranda to document compliance with a firm's engagement performance quality control component.

Assigning Responsibilities for Completion of the Engagement Level QC Steps

Referring to the bridging documents in Exhibits 2-17, 2-18, and 2-19, it is obvious that some of the quality control steps are ordinarily performed by a partner, while others can be delegated to a manager, supervisor, senior, or in-charge person. With regard to advancement, there are various levels of staff classifications that can be adopted by a firm. The responsibilities of each staff level can vary depending on the qualifications and maturity of personnel and the difficulties of each job. For these reasons, this course does not specify the staff title that should be responsible for completing a QC step. Instead, the term *engagement team* (ET) is used in Exhibits 2-17, 2-18, and 2-19 to refer to all nonpartner staff assigned to an engagement team. This approach gives the firm flexibility in delegating completion of the step to any qualified member of the engagement team. Also, it is a good idea for the bridging document to indicate whether a partner (P) or another member of the engagement team (ET) have primary or secondary responsibility for completing the step.

Indicating the Applicability of Steps to Each Type of Engagement

Some of the quality control steps illustrated in Exhibits 2-17, 2-18, and 2-19 are not applicable to every engagement covered by QC 10. One of the disadvantages of many engagement performance QC systems is that they make no distinction as to the applicability of the procedure to each type of engagement. For example, a requirement to prepare a time estimate and budget for each engagement might be appropriate for an audit, but inappropriate for a compilation. Bridging documents like those illustrated in Exhibits 2-17, 2-18, and 2-19 allow the firm to tailor its QC steps to fit each type of engagement.

How to Tailor the Bridging Document. The bridging documents in Exhibits 2-17, 2-18, and 2-19 include steps marked with a "Yes" response as necessary for that engagement either because of peer review considerations or professional literature requirements. Steps that indicate a "No" or "Optional" answer can be changed to a "Yes" at the discretion of the user. In reviewing the bridging document, you may note that certain "Yes" responses are more than the minimum required by professional standards. However, these steps are required in the PPC quality control system because these procedures may be the most cost-effective means of providing quality services and minimizing engagement risk.

Describing the QCM Used by the Firm

An integral part of a firm's QC system is its engagement work programs, checklists, sample confirmations and letters, and other practice aids. Such a system of practice aids is often referred to as *quality control materials* (QCM). The existing Peer Review Standards (PR 1000.154) indicate that quality control materials provide guidance to assist firms in performing and reporting in conformity with professional standards and may include, but are not limited to,

engagement aids such as checklists, questionnaires, work programs, electronic accounting and auditing tools, and similar materials designed to be used by accounting and auditing engagement teams. [The clarified peer review standards remove all guidance related to performing and reporting on reviews of quality control materials.] The importance of having QC procedures to help ensure that firms using third-party QCM appropriately update the QCM when necessary, and relevant information for firms that develop and maintain their own QCM are both discussed later in this section.

When designing the engagement performance QC system, the firm should indicate the QCM that are used in the system or make reference to the firm's audit or accounting materials that comprise the firm's QCM. Bridging documents can be used for this task.

QCM Will Be Reviewed during a Peer Review. During a system review, the review team will ask for copies of QCM used by the firm and whether the firm obtains its QCM from an outside source. If so, the review team will also ask whether the provider of the QCM has undergone a peer review. (How a firm's peer review related to QCM is expected to change under the clarified peer review standards is discussed later in this section.) If the provider has not undergone an independent peer review, the peer review team spends extra time reviewing the appropriateness of the QCM. For that reason, the firm will want to determine if the QCM used by the firm (if purchased from an outside source) is part of a comprehensive system of quality control that has been peer reviewed. The AICPA provides access to the peer review results for third-party providers of QCM that have undergone a QCM review on their website at us.aicpa.org/InterestAreas/PeerReview/Community/NationalPRC/QCMReviewResults.

The use of QCM in a firm's accounting and auditing practice becomes an integral part of its system of quality control, especially in the area of engagement performance. Accordingly, it is important for firms to ensure that the QCM being used is appropriate for its practice. Additionally, the QCM user's responsibilities as described in the QCM Review Report specifies:

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

That information stresses that the users of third-party QCM are responsible for the reliability and suitability of purchased QCM. Accordingly, it is important for users of third-party QCM to assign accountability to the QC partner (or other partner) to put procedures in place to ensure those responsibilities are met. The following procedures are suggested as appropriate and their performance (or lack thereof) could potentially affect the firm's peer review:

- Review of the QCM by the firm's quality control director at the time of initial purchase and when updated materials are purchased and/or received.
- Review of the QCM provider's peer review report by the firm's quality control director to determine whether the provider's report conclusion has changed (for example, from *pass* to *pass with deficiencies*) or the provider has removed from the review specific engagement performance products (for example, a provider ceases having one or more unique industry products peer reviewed). A peer review QCM report conclusion that has worsened or the absence of products being peer reviewed that the firm used previously would potentially require the firm to modify its QCM in one or more areas.
- Check the QCM provider's support site for new or corrected materials when unusual changes may be needed, such as when significant newly effective authoritative guidance is issued outside the normal QCM update cycle.
- Consider whether appropriate industry guidance for specialized industry clients is being used.

- Consider whether the QCM is comprehensive. In considering comprehensiveness, determine whether the materials include guidance for all types of accounting and auditing services the firm provides, and whether the materials provide the guidance and practice aids ordinarily needed for a complete engagement. When the QCM is not comprehensive, firms need to supplement the QCM for the materials that are not provided (and any supplemental materials need to be reviewed by the firm to ensure reliability).
- Consider whether the QCM is timely; that is, whether it includes all authoritative guidance by the FASB, AICPA, GAO, etc. that was in effect as of the QCM edition date. Ensure that the next edition of the QCM incorporates all relevant authoritative guidance issued or effective since the prior QCM edition.
- Tailor and supplement the materials as necessary so they are reliable and suitable for the firm's accounting and auditing practice. Tailoring and supplementing the materials may involve incorporating newly effective authoritative literature that is not included in the edition of the QCM used by the firm, or adding industry-specific guidance for which the QCM are not customized. For example, if general auditing materials are used on an audit engagement of a construction contractor client, those general materials may lack industry-specific audit programs and other guidance required for a contractor client, in which case the firm needs to supplement the general auditing materials with necessary industry-specific information.
- Document any changes made to the QCM by the firm.
- Integrate the materials into the firm's engagement performance system. (Use of paper vs. electronic materials will affect how QCM is integrated.)
- Notify staff when new or updated QCM is ready to be used. Based on the level of change in new or updated QCM, staff training may be necessary prior to using the revised QCM.

A firm that uses QCM also needs to know that—

- Significantly altered QCM (even QCM that received a peer review report of *pass*) may require the firm's peer reviewer to consider whether the firm's engagement methodology is appropriate.
- If the QCM provider's peer review report is other than *pass*, the firm's peer reviewer cannot automatically place reliance on the QCM to be appropriate for the firm's system of quality control. The peer reviewer may be required to consider the appropriateness of the firm's engagement methodology, including changes made by the firm to address the identified deficiencies in the QCM methodology.
- If the QCM provider received a *pass with deficiencies* or *fail* report, the firm's peer reviewer will be required to perform additional work to determine whether the QCM deficiencies affect the firm's QC system and the extent of reliance that can be placed on the QCM.

When a firm uses its own internally developed QCM (and an independent QCM review has not been performed on it), the peer review team will have to assess the suitability of the QCM utilized, including the firm's system for developing and maintaining the QCM. Such a review includes evaluating the processes and procedures for ensuring that—

- QCM authors and technical reviewers are qualified in the subject matter;
- review of the materials developed is performed by someone other than the original author;
- materials are current and relevant; and
- feedback from users is addressed.

Thus, the firm developing its own QCM should establish policies and procedures to (a) ensure that the materials developed are reliable and suitable for the firm's practice, and (b) maintain the material's reliability and suitability through appropriate updates and revisions, and designate the QC partner (or other partner) as responsible that the QCM-related procedures are followed. In a peer review, the firm's use of internally developed materials generally creates higher control risk, resulting in the need for additional peer review work.

QCM Examination Project. Since January 2019, the AICPA Peer Review Board has been working on a project to revise the QCM review process. In April 2019, the Peer Review Board revised Interpretations 42-2 and 42-3 and

added Interpretation 156-1 to allow either QCM reviews (under the extant Peer Review Standards) or QCM examinations (under the SSAEs) to be performed. Now, the clarified peer review standards, effective for reviews commencing on or after May 1, 2022, remove all guidance related to performing and reporting on reviews of QCM. Accordingly, once the clarified peer review standards are effective, providers of QCM will be required to undergo a QCM examination performed under the SSAEs. The transition to a QCM examination primarily affects QCM providers, but will also impact firms using QCM as further explained below. The AICPA Auditing Standards Board continues to work on establishing new QCM examination guidance, and it is expected that an SSAE exposure draft for QCM examination will be issued during 2022. An AICPA interpretative guide on performing and reporting on QCM examinations is also being developed.

Clarified Peer Review Standards Impact on Firms. As mentioned in the preceding paragraph, the clarified peer review standards remove all guidance related to performing and reporting on reviews of quality control materials for peer reviews commencing on or after May 1, 2022. Thus, for peer reviews commencing after that date, the procedures performed by peer reviewers with regard to a firm's use of QCM can be expected to change because the specific guidance that peer reviewer's currently follow to evaluate a firm's QCM will be eliminated. That is, after the clarified peer review standards are effective, it will be more evident that the evaluation and measurement of the appropriateness of QCM is the responsibility of the firm using the QCM.

QC 10 is the current authoritative guidance for determining whether a resource is appropriate for a firm's system of quality control, and that guidance puts the responsibility on the firm to establish and maintain its system of quality control. As previously discussed, QC 10.35 requires that firms establish policies and procedures to provide reasonable assurance that its engagements are performed in accordance with professional requirements, including promoting consistency in the quality of engagement performance. QC 10.A32 points specifically to the use of QCM as a common method used by firms to promote such consistency. While the peer reviewer will continue to evaluate the firm's design of and compliance with its system of quality control and the related QC elements (i.e., relevant ethical requirements, human resources, engagement performance, etc.), the peer reviewer will not evaluate the appropriateness of the firm's QCM. After the clarified peer review standards are effective—

- It will be more clear that the firm has the responsibility to evaluate the appropriateness of the QCM and ensure that materials used are reliable and suitable for the firm's accounting and auditing practice. Thus, the information above, addressing firm responsibilities for the use of QCM, will continue to be important to consider.
- The procedures that peer reviewers will perform related to a firm's use of QCM are currently unknown. Accordingly, certain information above, related to what the peer reviewer may or may not do, could no longer be accurate after the clarified peer review standards are effective. However, see the next bullet.
- Based on information provided in a recent Peer Review Board meeting, it is anticipated that the AICPA peer review program will help promote the importance of a firm's consideration of QCM examination results to support the firm's system of quality control. Further, peer reviewers may use the results of the QCM examination to assist in evaluating the reliability of the QCM used by the firm. An unmodified opinion would generally provide lower control risk for the reviewers' assessment of peer review risk. A qualified, adverse, or disclaimer opinion would generally increase control risk and may increase the scope of the firm's peer review. (Under the SSAEs, an examination results in an unmodified, qualified, adverse, or disclaimer opinion.)

A future edition of this course will provide further information about the QCM examination project.

Importance of Tailoring Bridging Documents. It is important for firms to tailor the bridging documents in their QCM to their engagement performance system. If firms are not following the bridging document as written, they should modify it to fit their own needs and procedures. Otherwise, a peer review deficiency may result from failure to follow the firm's documented system.

Incorporate the Applicable QC Engagement Performance Steps Into the Engagement Work Program. To ensure that the firm's QC steps are actually performed on each engagement, it is a best practice that the firm's work programs and checklists for each type of engagement contain the quality control steps adopted by the firm. In other words, the engagement work program is the vehicle that enables the firm to comply with its stated quality control

procedures. The use of standardized work programs is recommended to ensure that the procedures are performed on each engagement. Each PPC product contains work programs/checklists that incorporate the QC steps in the bridging documents in Exhibits 2-17, 2-18, and 2-19.

Unique Engagement Performance Issues for Compilations. Firms may provide a variety of types of compilation services. For example, compilation engagements can include interim and year-end financial statements, historical and prospective information and financial statements, GAAP and special purpose framework financial statements (e.g., tax basis), and those with and without disclosures. Additionally, compiled financial statements may be prepared by professional accountants, paraprofessionals, or bookkeepers. Preparation of compiled financial statements may involve creating the statements from source documents (including complete bookkeeping services), creating the statements from client-provided ledgers (including a limited number of adjustments), adding disclosures to client-prepared statements, adjusting and finalizing client-prepared statements, or some combination of any of those tasks. So much variety for one type of engagement can make it challenging to establish engagement performance quality control steps for compilation engagements.

Appropriate procedures should be in place and followed for each type of compilation engagement. Obviously, it is not necessary for the procedures to be the same for each engagement type. For example, some firms use abbreviated checklists for interim engagements. Also, some firms may require an engagement quality control review for all full disclosure compilation engagements, but not for compilation engagements with financial statements without disclosures. It is important that firms specify in their bridging document or elsewhere the differing QC procedures related to the particular types of compilation engagements. As long as the firm meets the minimum requirements of that type of engagement and conforms to its specified QC procedures, peer reviewers, as mentioned above, will be satisfied.

Developing Policies and Procedures for Maintaining Engagement Documentation

Document Retention. When firms establish document retention policies, various considerations enter into the decision of how long to maintain records:

- Authoritative, legal, and regulatory requirements, if any, need to be considered. Certain types of records may have specific requirements.
- Advice from legal liability insurance carriers and/or attorneys may be factored into the decision.
- Firms not utilizing electronic engagement documentation will want to consider the cost of storage space and the administrative burden of maintaining paper records.
- For all firms, keeping records indefinitely is both costly and unnecessary.

So how long should the firm keep its files? The answer varies depending on the above considerations.

As previously discussed, AU-C 230 requires audit documentation to be maintained for a minimum of five years. In addition, firms often base how long they keep workpapers on the length of the statute of limitations for breach of contract, breach of fiduciary duty, and professional liability claims. Example retention periods for engagement documentation are presented in Exhibit 2-20; however, the retention periods are only examples. The firm may want to consult its state board of accountancy, attorney, and insurance carrier when establishing a document retention policy. In addition, reviewing the policy annually and updating it as necessary is recommended, considering changes in governmental and professional requirements and the cost of retaining records.

Exhibit 2-20**Example Engagement Document Retention Policy**

	Retention Period^a	
	<u>Current Client</u>	<u>Former Client</u>
Draft financial statements and reports	Until engagement completion	N/A
Financial statements and reports	Indefinitely	7 years
Current workpaper files	7 years	7 years
Client correspondence files	7 years	7 years
Permanent files	Indefinitely	7 years

Note:

- ^a These are example document retention periods only. Document retention policies should generally correspond with the longest statute of limitations that prevails in states in which the firm does business. Records related to pending legal proceedings must be kept until the proceedings are completed. Firms should consult their state board of accountancy to determine the applicable requirements in their states.

Confidentiality, Custody, Integrity, Accessibility, and Retrievability of Engagement Documentation. Firms should develop consistent policies, procedures, and underlying controls for all engagements that address confidentiality, safe custody, integrity, accessibility, and retrievability. Such controls may need flexibility based on the stage of the engagement (e.g., fieldwork still in progress, after fieldwork but before the report is issued, and after the report has been issued and the engagement documentation has been assembled) as well as the nature of the engagement documentation media (e.g., paper or electronic). Policies and procedures for protection and security of the workpapers need to include direction to personnel concerning the appropriate handling of laptops (which are susceptible to damage, theft or loss, hard drive failure, or accident), including backup procedures, to minimize the threat of loss of work effort and protection of the client's information.

Developing Policies and Procedures for Consultation and Resolving Differences of Opinion

As mentioned earlier in this lesson, QC 10 requires firms to establish policies and procedures for appropriate consultation and addressing and resolving differences of opinion when circumstances warrant for all engagements subject to the firm's system of quality control.

Consultation Considerations. In designing the firm's engagement performance QC system, the following key considerations related to consultation might be kept in mind:

- **Encourage Consultation.** The myriad of professional standards and applicable legal and regulatory requirements, as well as the ongoing changes in many of those standards and requirements, have resulted in an increased need for consultation on technical issues. In today's environment, no one is expected to know all the answers. As a result, the firm's policies and procedures are best drafted in a way so as to encourage, rather than discourage, the use of consultation.
- **Allow a Voice for Minority Opinion.** Consultations are serious matters, and at stake, among other things, is potential legal liability to the firm if a wrong decision is made. Consequently, the opinions of all parties to a consultation need to be carefully considered, even if the opinion is unpopular. Furthermore, consultation QC systems should include a procedure to allow someone who disagrees with the resolution to a consultation to document their disagreement in the engagement documentation.
- **Provide Documentation.** Designing a policy for documenting consultations can be troublesome because it is often difficult to determine when an issue is worthy of documentation. Many consultations initially seem to deal with unusual or complex issues that turn out to be inconsequential. Other consultations deal with

issues significant enough to be documented. As a result, the firm's documentation requirements should be specific enough for engagement personnel to understand what types of consultation issues warrant documentation, but flexible enough to allow engagement personnel to exercise their professional judgment. Documenting consultations should be sufficiently complete and detailed to provide an understanding of (a) the issue that triggered the need for consultation and (b) the results of the consultation, including decisions made, the reasons for those decisions, and how they were implemented.

Establishing Steps to Perform a Consultation. The consultation process typically evolves through the following stages:

- a. Establish policies and procedures to ensure that consultation occurs when appropriate (that is, when confronted with complex, unusual, unfamiliar, difficult, or contentious issues).
- b. Once a situation requiring consultation is identified, discuss the issue creating the need for consultation with members of the engagement team.
- c. Ensure that sufficient and appropriate resources (such as current versions of relevant technical pronouncements and industry guidance) are available to allow meaningful consultation to occur.
- d. If the issue cannot be resolved at the engagement team level, consult with an in-firm specialist who has the experience and technical expertise to provide appropriate professional judgment to facilitate solving the situation requiring consultation.
- e. If the issue cannot be resolved within the firm, consult outside of the firm with an individual or other firm with the relevant specialized expertise to provide appropriate professional judgment to facilitate solving the situation requiring consultation.
- f. Agree with the individual consulted about the nature and scope of consultations and the conclusions reached and understood.
- g. Document the nature and scope of consultations and the conclusions reached and implement the decision.

Those steps can be used by any size firm and may help minimize research time and the cost of using an outside specialist by giving staff direction on how to resolve an issue that requires consultation.

Designating In-firm Specialists. Some large firms may include a consultation procedure whereby specific individuals within the firm are designated as specialists for an array of possible industries, types of engagements, new or complex accounting requirements, etc. While it may be necessary to designate various individuals within a large firm, in small firms and sole proprietorships, it is generally not necessary to make such designations because the particular expertise or specialty of each staff member is common knowledge. Therefore, in lieu of designating and preparing a list of firm specialists, firms could state in the QC procedures that the managing partner be consulted if the engagement team is not aware of the name of a specialist within the firm.

Designating Outside Specialists. Some firms elect to state in their quality control policies the name of outside specialists that the firm wants engagement teams to consult with when an issue requiring consultation is encountered. Specialists outside the firm may include advisory services provided by other firms, professional and regulatory bodies, and commercial organizations that provide relevant quality control services. Advisory services provided by other firms may be, for example, the technical arm of an association of firms or a specific CPA that has established a consulting relationship with the firm. One professional body that provides advisory services to its members is the AICPA, which responds to inquiries on complex accounting, auditing, attestation, and accounting and review issues. Inquiries may be submitted electronically to the AICPA at the website [us.aicpa.org/Research/TechnicalHotline](https://www.aicpa.org/Research/TechnicalHotline), or by calling (877) 242-7212. Before using an outside specialist's services, QC 10.A40 indicates that considering the external provider's competence and capabilities helps the firm evaluate whether the external provider is qualified for that purpose.

Assigning Responsibility for Resolving Differences of Opinion. Throughout the engagement process, disagreement among parties involved as to the proper answer or course of action for resolving a difference of opinion issue may occur. Generally when such a difference of opinion occurs, it can be resolved through adequate library

research or by obtaining the opinion of in-house or outside specialists. In the infrequent situation where a disagreement still exists after those steps have been taken, a firm's quality control procedures may appoint a person in the firm to mediate the difference of opinion and make a final determination of the firm's resolution to the issue. The managing partner or the quality control director is ordinarily an appropriate individual to make the final determination, although others may also be appropriate.

QC 10.48 requires that differences of opinion be resolved before the engagement report is released. However, even after a final determination has been made by the firm, one or more members of the engagement team may disagree with the chosen resolution. It may be acceptable to have dissenting opinions about the final resolution to the difference of opinion and still consider that the issue has been resolved and the report can be released. The firm's QC document should include a procedure allowing individuals who disagree with the final resolution to document their disagreement.

Developing Engagement Quality Control Review Policies and Procedures

In developing policies and procedures over engagement quality control review (EQCR), the firm should initially establish criteria against which all engagements subject to QC 10 are to be evaluated. If an engagement meets the criteria the firm has established, an EQCR is to be performed. The EQCR is to be performed before the engagement report is issued. If an engagement does not meet the firm's criteria, then no engagement quality control review is required to be performed.

Once the EQCR criteria have been developed, the firm should establish a procedure to ensure that all appropriate engagements are compared to the EQCR criteria. Such a step could be included in all work programs used by the firm. Alternatively, firms may choose to consider earlier in the engagement whether an EQCR will be performed, and thus, firms may add a step to the firm's pre-engagement planning checklist. In any given engagement, events may occur after the engagement has begun that prompt the engagement partner or managing partner to have an EQCR performed even though the engagement did not initially meet the EQCR criteria. Accordingly, the firm may need to reconsider whether an engagement meets EQCR criteria before the end of the engagement.

Firms may want to develop EQCR criteria that are easy, rather than complex, to evaluate against, bearing in mind that the objective of establishing EQCR criteria is to identify engagements that need additional review.

Addressing Nature, Timing, Extent, and Documentation of EQCR. The firm should establish quality control procedures that address how an EQCR will be performed for those engagements that meet the EQCR criteria.

Timing of Review. Such procedures address the timing of the review while complying with the requirement to complete the review before the report is released. Thus, firms may determine that reviews be conducted at appropriate stages throughout the engagement.

Nature and Extent of Review. QC 10 provides requirements for procedures that firms should perform as part of conducting an EQCR. Firms may choose to include additional procedures when performing EQCRs. The specific situation, such as the complexity of the engagement and/or the risk that the report might not be appropriate, may expand the extent of the review.

Documenting the Review. QC 10.45 provides the documentation requirements for EQCRs, as discussed earlier in this lesson.

Establishing the Eligibility of Engagement Quality Control Reviewers. In general, the firm's policies and procedures for eligible engagement quality control reviewers should address the appointment of such individuals and the technical qualifications the firm requires for individuals to perform that role, including necessary experience and authority within the firm. The specific requirements listed in QC 10 were discussed earlier in this lesson. If firms do not have a suitably qualified individual to perform the review, the firm may contract with such an external individual or firm. Those contracted with should also meet the requirements for engagement quality control reviewers.

EVALUATING OVERALL ADEQUACY OF THE QC SYSTEM'S DESIGN

The ideas, recommendations, and suggestions in this lesson can assist the firm in designing a practical engagement performance quality control system. The ultimate responsibility for the system, however, resides with the firm. *PPC's Guide to Quality Control* includes checklists to help determine whether the engagement performance policies and procedures meet the firm's needs and provide reasonable assurance that the firm complies with QC 10. Those checklists provide a summary of what the quality control policies and procedures for each QC element need to address. Reviewing the questions in the engagement performance section of the appropriate checklist will be useful in performing a final assessment of the firm's quality control policies and procedures for this QC element.

As previously mentioned in this lesson, the majority of matters noted by peer reviewers arise during their review of specific engagements and most relate to the engagement performance element. This course suggests that the firm consider examples of engagement performance matters noted in peer reviews in making a final evaluation of its QC system. The information included in the following exhibits is based on examples of noncompliance with applicable professional standards provided in recent years by the AICPA Peer Review Board. Exhibit 2-21 provides a listing of engagement performance matters noted in all types of engagements. Exhibit 2-22 focuses on matters noted in employee benefit plan audits, while Exhibit 2-23 provides information on matters noted during governmental audits. Additionally, Exhibit 2-24 is a listing of matters noted during nonprofit engagements and Exhibit 2-25 provides information on matters noted during SOC reporting engagements. Finally, the firm may also wish to consider examples of consultation matters noted in peer reviews as illustrated in Exhibit 2-26. (Because matters in the following exhibits are derived from peer reviews, selected matters could relate to requirements that have been superseded by recently issued authoritative standards and/or changing terminology.)

Exhibit 2-21

Engagement Performance Matters Noted in Peer Reviews

Engagement Deficiencies

Reports:

- Failure to appropriately qualify an auditor's report for a scope limitation or departure from the basis of accounting used for the financial statements.
- Failure to include in an auditor's report, an appropriate reference to the predecessor auditor in an Other Matter paragraph.
- Failure to prepare auditor's, practitioner's, or accountant's reports in accordance with professional standards (for example, not updating for recently issued authoritative pronouncements).
- Issuance of an audit or review report when the accountant is not independent.
- Failure to disclose the lack of independence in a compilation report.
- Failure to disclose the omission of substantially all disclosures (in a compilation without disclosures).
- Failure to disclose the omission of the statement of cash flows in financial statements prepared in accordance with GAAP.
- Failure to disclose, in the accountant's or auditor's report, a material departure from professional standards.
- Failure to include in an agreed-upon procedures report—
 - Reference to the AICPA attestation standards.
 - A statement that the sufficiency of the procedures is the responsibility of the specified parties and a disclaimer of responsibility for the sufficiency of those procedures.
 - A paragraph that restricts the report to specific users.
- Inappropriate references to GAAP in the accountant's report on financial statements prepared under a special purpose framework (for example, cash or tax basis).
- Reports dated incorrectly, issued without a date, or without appropriate reference to all time periods covered by the financial statements.
- Reports reflecting financial statement titles and terminology not in accordance with professional standards.
- With regard to reporting on supplementary information—
 - Failure to explain the degree of responsibility the accountant or auditor is taking with respect to supplementary information included in the financial statements.
 - Failure to identify all supplementary information presented.
 - Use of outdated report language.

- Failure to indicate the accountant's responsibility with respect to all periods presented in a report on comparative financial statements.
- For a compilation or review engagement performed under the SSARS, failure to appropriately modify the report to follow professional standards when the financial statements are prepared using a special purpose framework.
- For a SSARS engagement, failure to appropriately date the report.
- For a preparation engagement, failure to issue a disclaimer as required by the SSARS when the accountant neglects to include a statement on each page of the financial statements indicating, at a minimum, that "no assurance is provided."

Financial Statement Measurement and Presentation:

- Inclusion of material balances that are not appropriate for the basis of accounting used.
- Failure to include a material amount or balance necessary for the basis of accounting used.
- Significant departures from the financial statement formats prescribed by industry audit and accounting guides.
- Improper accounting of a material transaction.
- Misclassification of a material transaction or balance.
- Failure to include a statement of cash flows.
- Failure to segregate the statement of cash flows into the components of operating, investing, and financing.
- Misclassification of items on the statement of cash flows.
- Omission of statement of income and retained earnings when referred to in the report.
- Failure to segregate the current portion of long-term debt.
- Failure to refer to the accountant's report on each page of the financial statements and financial statements inconsistently titled with the applicable reports.
- Supplementary information not clearly segregated or marked as supplementary and departs from standard report presentation with respect to supplementary information.
- Financial statement titles on computer generated financial statements that are inconsistent with the accountant's report.
- Material depreciation miscalculations not corrected in the financial statements and/or depreciation on specific newly acquired assets omitted from the financial statements.
- Failure to appropriately complete financial statement and disclosure checklists.

Disclosure:

- Omission of significant matters related to the understanding of the financial statements (the cumulative material effect of a number of deficiencies).
- Failure to include a subsequent events disclosure related to potential negative financial impact resulting from the COVID-19 pandemic.
- Failure to appropriately implement FASB ASC 606, including adding newly required disclosures.
- Failure to update inventory disclosures to reflect lower of cost or net realizable value.
- Failure to include a summary of significant assumptions in a financial forecast or projection.
- Omission of significant required disclosures related to material financial statement balances or transactions.
- Failure to disclose the cumulative effect of a change in accounting principle.
- Omitted or inadequate disclosures.
- Missing disclosures in the financial statements where the item to be disclosed was included in a disclosure checklist used in preparing the financial statements.
- Failure to appropriately disclose fair value hierarchy of investments, description of the levels, description of the assumption methods used, and tabular presentation of amounts.
- Failure to disclose five years of debt maturities as required.
- Failure to disclose risks and uncertainties (such as nature of operations, the use of estimates, and concentrations) as required.
- Failure to disclose the date through which subsequent events were evaluated.
- For a preparation engagement where the financial statements were prepared using a special purpose framework, failure to include a description of the financial reporting framework.

- For a preparation engagement where the accountant prepared financial statements containing known departures from GAAP, failure to disclose material financial statement misstatements.

Audit Procedures and Documentation:

- Failure to communicate and/or document the auditor's communication with those charged with governance.
- Failure to provide documentation containing sufficient competent evidence to support the firm's opinion on the financial statements.
- Failure to communicate internal control matters as required by AU-C 265.
- Failure to appropriately document audit planning procedures, including—
 - Risk assessment and the linkage of risks to audit procedures performed.
 - Planning analytics.
 - Understanding of the entity's IT environment.
 - Internal control testing.
 - Consideration of going concern.
- Failure to properly support and document the assessed level of risk, including—
 - Assigning control risk at less than high, but not testing effectiveness of the related controls.
 - Performing risk assessment at the audit level rather than at the relevant assertion level.
 - Not identifying or documenting the relevant risks and controls associated with IT's role.
- Failure to consult industry audit and accounting guides or to perform essential audit procedures required by such guides.
- Failure to tailor audit programs for specialized industries or for a specific type of engagement.
- Failure to obtain a client management representation letter and/or failure to request a legal representation letter.
- Omission of key components in a client management representation letter.
- Failure to assess or document fraud considerations.
- Failure to observe inventory when the amount is material to the balance sheet.
- Failure to confirm significant receivables or document appropriateness and utilization of other audit techniques.
- Failure to assess the level of materiality and control risk.
- Failure to perform an adequate review of the engagement workpapers and/or the auditor's report and accompanying financial statements by the practitioner-in-charge of the engagement prior to the issuance of the auditor's report.
- Failure to test for unrecorded liabilities.
- Failure to review loan covenants supporting current and long-term liabilities.
- Failure to perform audit cut-off procedures.
- Failure to perform a review of subsequent events.
- Failure to perform adequate tests or substantial documentation deficiencies in key audit areas.
- Failure to perform sufficient procedures or sufficiently document procedures performed to obtain assurance of fair value measurements.
- Documentation deficiencies related to substantive tests and failure to document considerations of sample selection.
- Failure to appropriately project the results of sampling to the population.
- Dating discrepancies between the dating of management representation letters and/or legal representation letters, and the last day of fieldwork.
- Failure to sign off on audit program steps in audit programs.
- Failure to include appropriate references to client responsibilities concerning fraud in the engagement letter.
- Failure to perform or document the discussion among the audit team regarding the susceptibility of the entity's financial statements to misstatement due to error or fraud.
- Failure to document expectations prior to performing analytical procedures and/or failing to compare final results to expectations as well as document the procedures performed.
- Failure to appropriately document:
 - The levels of materiality and tolerable misstatement, including any changes thereto, used in the audit and the basis on which those levels were determined.
 - Communications between predecessor and successor auditors.
 - Compliance with the independence interpretation requirements of *Nonattest Services* at ET 1.295.

- The nature, timing, and extent of the further audit procedures.
- Consideration of nonstandard journal entries.
- The auditor's evaluation of the professional qualifications of an actuary or plan auditor.
- The evaluation of uncorrected misstatements, as required by AU-C 450.12.
- A conclusion about whether uncorrected misstatements, individually or in aggregate, do or do not cause the financial statements to be misstated, and the basis for that conclusion.
- Key elements of the understanding obtained regarding each of the aspects of the entity and its environment.
- The linkage between risk assessment procedures and actual substantive procedures performed.
- Inquiries of those charged with governance required by fraud risk assessment procedures.
- Failure to establish appropriate criteria for Engagement Quality Control Review (EQCR).
- Failure to perform EQCR on engagements that meet the firm's criteria.
- Failure to maintain current quality control materials for the performance of engagements.
- Failure to properly use the firm's designated accounting and auditing QCM developed by third-party providers, resulting in engagement deficiencies.
- Failure to establish a policy for the retention of engagement documentation.

SSARS Procedures and Documentation:

- For a review engagement—
 - Failure to disclose departures from the financial reporting framework.
 - Failure to segregate the current portion of long-term debt.
 - Failure to perform and document analytical and inquiry procedures.
 - Failure to develop and document expectations prior to performing analytical procedures and/or to compare results to those expectations.
 - Failure to obtain a management representation letter, or the management representation letter obtained had errors or omissions in the representations included, was not dated appropriately, and/or failed to include appropriate financial statement periods.
 - Failure to document significant unusual matters noted and their disposition.
- Failure to obtain an engagement letter or the engagement letter failed to contain all elements required by the SSARS.
- Failure to obtain all required signatures on the engagement letter.
- The engagement letter did not refer to supplementary information, which was presented along with the basic financial statements.
- Failure to document significant findings and issues.
- Failure to document communications with management about fraud or noncompliance with laws and regulations.

Attestation Procedures and Documentation:

- Failure to clearly identify the responsible party and/or failure to have the responsible party accept responsibility for its assertions or subject matter (pre-SSAE No. 19).
- Failure to appropriately label pro forma information to distinguish it from historical financial information.
- Failure to include a summary of significant assumptions in a financial forecast or projection.
- Failure to obtain an engagement letter, or failure to include all elements required in the engagement letter.
- Failure to provide appropriate documentation concerning agreed-upon procedures.

Financial Statements

Assets:

- Improper classification between current and long-term assets.
- Investment in majority owned or controlled subsidiary not consolidated.
- Bank overdrafts shown as a negative asset balance.
- Improper recording of capital leases as operating leases (pre-FASB ASC 842).
- Incorrect or inadequate disclosure of the basis of accounting for trade receivables.
- Accounts receivable shown on cash basis financial statements.
- Investments in debt and equity securities not classified or measured correctly.

Liabilities:

- Improper classification of deferred income taxes and/or failure to accrue income taxes.
- Improper classifications between current and long-term debt.
- Demand liabilities classified as long-term.
- Nonrecognition of a liability for compensated absences.
- Nonrecognition of capital leases (pre-FASB ASC 842).
- Improper recognition of deferred revenue (pre-FASB ASC 606).

Statement of Income:

- Income tax provision, where applicable, not recorded in interim financial statements.
- Income tax expense presented as an operating expense rather than as a separate line item.
- Use of inappropriate method of revenue recognition (pre-FASB ASC 606).

Statement of Cash Flows:

- Cash flow statement not categorized by operating, investing, and financing activities.
- Misclassification of activities, especially between investing and financing activities.
- No disclosure of noncash investing and financing activities.
- No disclosure of interest and income taxes paid for indirect statement of cash flows (may be in the notes).
- Cash flow statement not presented for each period for which a statement of income is presented.
- Material errors on interim period presentations of the statement of cash flows.
- No reconciliation between net income and net cash flow from operations.

Exhibit 2-22

Matters for ERISA Employee Benefit Plan Audits

- Inadequate audit documentation in the following areas:
 - Risk assessment.
 - Tests of controls.
 - Sampling.
 - Reliance on and evaluation of a SOC 1 report.
 - Allocation of investment income to participant accounts.
- Failure to report significant plan information, such as related party transactions and prohibited transactions between a plan and a party in interest.
- Failure to obtain an understanding of the actuary's objectives, scope of work, methods and assumptions, and consistency of application on defined benefit plans.
- Failure to properly reflect changes in authoritative standards addressing investments, including fair market value reporting.
- Insufficient testing of participant payroll and demographic data.

- Failure to present IBNR obligations or the related required disclosures.
 - Failure to properly report on and/or include the required supplemental schedules relating to ERISA and DOL.
-

Exhibit 2-23

Matters for Government Auditing Standards Audits

Reporting:

- Failure to include all required elements of professional standards in the Independent Auditor's Report, including the following omissions: titles, reference to the engagement being performed in accordance with *Government Auditing Standards*, identification of the governmental entity's major funds and opinion units presented, addressing supplemental information and required supplemental information, and reference to prior-year financial statements when comparative years are presented.
- Failure to include all required elements of professional standards in the Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters, including: omitted "Independent" from report title, omitted or incorrect reference to material weaknesses or significant deficiencies included in the Schedule of Findings and Questioned Costs, and indication that there were no significant deficiencies identified.
- Inadequate documentation related to the agreed-upon procedures engagement that accompanies a public housing authority or multifamily single audit.
- Failure to report findings in the appropriate form in the Schedule of Findings and Questioned Costs.

Disclosure and Presentation:

- Failure to present the financial statements in accordance with professional standards, including Fund Balance and Net Position presentation and reconciliations; presentation of funds; missing significant policy footnotes; missing disclosures related to fair value, debt, investments, accounts receivable, and improper financial statement titles.
- Failure to include the REAC financial data template supplemental information as required by HUD.

Documentation and Performance:

- Failure to properly document independence considerations required by Yellow Book, including the evaluation of management's skills, knowledge, and experience to effectively oversee nonaudit services performed by the auditor; evaluation of significant threats; and safeguards applied to reduce threats to an acceptable level.
- Failure to meet the Yellow Book CPE requirements, including 80 hours of A&A and 24 hours of CPE that directly relates to government auditing, the government environment, or the specific or unique environment in which the auditee operates.
- Failure to document required communications with those charged with governance, including proper communication of internal control findings.
- Failure to ensure that the written representations from the audited entity contained all applicable elements, including: representations tailored to the entity and governmental audit regarding federal awards and representations covering both years when comparative financial statements are presented. Also, improper consideration of the date of the representations in relation to the audit report.
- Failure to properly document evaluation of the actuary's qualifications (auditor's specialist).
- Inadequate procedures related to census data testing.

Single Audit:

- Failure to identify and test sufficient and appropriate major programs, failure to cluster, failure to properly perform Type A and Type B program risk assessments, failure to group programs with the same CFDA number, and incorrect determination of the auditee as low-risk resulting in insufficient coverage.
- Failure to properly conclude and document either that an applicable compliance requirement does not apply to the particular auditee or that noncompliance with the requirements could not have a direct and material effect on a major program.

- Failure to document an understanding of internal control over compliance of federal awards sufficient to plan the audit to support low assessed level of control risk for major programs, including consideration of risk of material noncompliance (materiality) related to each applicable compliance requirement and major program.
- Failure to document the adequacy of the planned sample size for test of controls over compliance to achieve a low level of control risk.
- Lack of documentation of risk of material noncompliance for the major program's compliance requirements occurring due to fraud.
- Lack of documentation related to the SEFA:
 - Internal controls over the preparation of the SEFA.
 - Procedures to determine whether the SEFA is fairly presented in all material respects.
 - Reconciliation of the SEFA to amounts in the financial statements.
- Lack of documentation of consideration of subsequent events related to the major program and its compliance requirements.
- Failure to document the testing of controls and compliance for the relevant assertions related to each applicable compliance requirement with a direct and material effect for the major program, including insufficient documentation and usage of dual purpose tests.

Exhibit 2-24

Matters for Service Organization Control (SOC) Reports

- Failure to obtain the experience and training required under SSAE No. 18 to properly complete a SOC report.
 - Failure to include required elements in the report, such as:
 - Complementary user entity controls.
 - Carve outs.
 - Criteria for the principles being opined on.
 - Management responsibilities.
 - All controls in the control activity section.
 - Failure to provide appropriate documentation supporting information in the report, such as procedures to:
 - Assess the nature, timing, and extent of the procedures (specifically sampling methodology).
 - Test carve outs.
 - Support the "Other Information" included in the report.
 - Assess the suitability criteria to evaluate whether management's description of the service organization's system is fairly presented.
 - Assess the completeness and accuracy of population files.
 - Use of incorrect references or language in a SOC 1 report.
 - Use of nonstandard wording related to complementary user entity controls in a SOC 2 report.
 - Failure to sufficiently test controls, including:
 - Addressing the elements of the control.
 - All IT general controls.
 - Change management controls.
 - Failure to document planned deviations in sample size.
 - Failure to coordinate the use of inquiry with other procedures.
 - Failure to ensure management's assertions were sufficient in detail.
-

Exhibit 2-25**Matters for Nonprofit Engagements**

- Failure to acquire the professional knowledge and training necessary to perform nonprofit engagements.
 - Report did not refer to the Statement of Functional Expenses.
 - Net assets were not properly presented as “without donor restrictions” or “with donor restrictions” in the financial statements.
 - The Statement of Functional Expenses contained improper expense classifications.
 - Failure to include required qualitative disclosures in financial statements per the new requirements of ASU 2016-14.
 - Accounting policies regarding donated goods and services were not disclosed.
 - Inadequate disclosure of the nature, amounts, and types of net asset restrictions.
 - Failure to include the required financial statement disclosure on liquidity and availability.
-

Exhibit 2-26**Consultation Matters Noted in Peer Reviews**

- Library not utilized because staff is not comfortable with research.
 - Library does not contain appropriate technical manuals and guidance materials relative to the firm's practice and/or contains outdated versions.
 - Failure to document consultation performed.
 - Failure to identify situations where, because of the nature or complexity of the subject matter, consultation is generally needed.
 - Failure to consult when required by firm policy.
 - Consultations that are insufficiently thorough and result in the wrong conclusion.
-

All PPC accounting and auditing materials provide engagement programs, disclosure checklists, and other practice aids that address the engagement areas noted in Exhibits 2-21, 2-22, and 2-26. Use of bridging documents will aid the firm in ensuring that all necessary procedures are performed and adequately documented.

MONITORING COMPLIANCE WITH ENGAGEMENT PERFORMANCE POLICIES AND PROCEDURES

The firm should review, on an ongoing basis, its engagement performance 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 inspection/review 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.

19. Which of the following is an example of a quality control procedure for engagement performance?
 - a. Planning for engagements meets professional, regulatory, and firm requirements.
 - b. Qualified engagement team members review work performed by other team members on a timely basis.
 - c. The engagement partner does not select the engagement quality control reviewer.
 - d. Engagements are performed, supervised, documented, and reported (or communicated) in accordance with the requirements of professional standards, applicable regulators, and the firm.
20. What term is used for a worksheet that firms may use to show its engagement performance steps for quality control for each engagement type?
 - a. Accounting and auditing materials.
 - b. A bridging document.
 - c. A practice aid.
 - d. The quality control document.
21. Which of the following guidance best describes an aspect of a firm's use of quality control materials (QCM)?
 - a. If the QCM is obtained from a peer-reviewed third party, it is exempt from consideration in the firm's system review.
 - b. If the firm develops its own QCM, the peer review process is less comprehensive because such QCM is automatically tailored for the firm.
 - c. Bridging documents only need a basic idea of the firm's QCM, as they do not need to be followed exactly.
 - d. It is important for QCM to be appropriate as it becomes an integral part of the firm's system of quality control.
22. Typically, once a situation requiring consultation has been identified, what is the next thing that should be done?
 - a. The issue should be discussed amongst the engagement team.
 - b. Policies and procedures for consultations should be established.
 - c. A specialist outside the firm should be selected.
 - d. Document the nature and scope of the expected consultation.
23. Which of the following is an engagement deficiency often noted in peer reviews?
 - a. The auditor's report is qualified for a scope limitation.
 - b. An omission of the statement of cash flows in GAAP financial statements.
 - c. Failure to include comparative GAAP references in reports on statements using other frameworks.
 - d. The use of incorrect financial statement titles or terminology.

24. Which of the following is a consultation matter often noted in peer reviews?
- a. The consultation is documented in too much detail.
 - b. An incomplete firm library.
 - c. Firm policy does not allow for enough consultation.
 - d. Consultations that take too long.

SELF-STUDY ANSWERS

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

19. Which of the following is an example of a quality control procedure for engagement performance? **(Page 78)**
- a. Planning for engagements meets professional, regulatory, and firm requirements. [This answer is incorrect. This is an example policy provided in the AICPA Practice Aid. An associated procedure would be, "The firm provides personnel with the firm's practice aids that prescribe the factors the engagement team should consider in the planning process and the extent of documentation of those considerations."]
 - b. Qualified engagement team members review work performed by other team members on a timely basis. [This answer is incorrect. This illustrates a policy related to engagement performance, not a procedure. An example procedure that could be included, per the AICPA Practice Aid, is, "The firm's methodology prescribes who on the engagement team reviews the work of other members of the engagement team."]
 - c. **The engagement partner does not select the engagement quality control reviewer. [This answer is correct. As illustrated in the AICPA Practice Aid, this is an example of a procedure. It would be associated with the following illustrative policy: "Engagement quality control reviewers meet the firm's criteria for eligibility."]**
 - d. Engagements are performed, supervised, documented, and reported (or communicated) in accordance with the requirements of professional standards, applicable regulators, and the firm. [This answer is incorrect. This is a policy, not a procedure, illustrated in the AICPA Practice Aid. An example procedure that would be associated with this policy is, "Each engagement is assigned an engagement partner who accepts ultimate responsibility for the engagement."]
20. What term is used for a worksheet that firms may use to show its engagement performance steps for quality control for each engagement type? **(Page 87)**
- a. Accounting and auditing materials. [This answer is incorrect. Firms can make reference to the engagement procedures and checklists in the accounting and auditing materials in the quality control document. However, these materials are not considered a separate worksheet, as described above. Also, using the accounting and auditing materials can be problematic if the firm does not follow every procedure verbatim.]
 - b. **A bridging document. [This answer is correct. A compromise between putting the quality control steps in the quality control document and putting them in the accounting and auditing materials is building a bridging document. A *bridging document* is the term used in this course to describe a worksheet that shows the engagement performance quality control steps performed by the firm for each type of engagement. Such a worksheet allows the firm to tailor its procedures to fit the type of engagement and to interface its quality control document into the checklists, forms, and practice aids used by the firm.]**
 - c. A practice aid. [This answer is incorrect. Practice aids are used by firms when they perform engagements. They would generally cover the steps for one type of engagement, not all engagement types.]
 - d. The quality control document. [This answer is incorrect. While these steps can be outlined in the quality control document, this document would not be considered a worksheet, as it contains other information, as well.]

21. Which of the following guidance best describes an aspect of a firm's use of quality control materials (QCM)? **(Page 94)**
- a. If the QCM is obtained from a peer-reviewed third party, it is exempt from consideration in the firm's system review. [This answer is incorrect. During a system review, the review team will ask for copies of the QCM used by the firm and whether the firm obtains its QCM from an outside source. If so, the team will also ask whether the provider of the QCM has undergone peer review. If the provider has not undergone peer review, the peer review team spends extra time reviewing the appropriateness of the QCM. However, the peer review team will still look at the QCM, either way.]
 - b. If the firm develops its own QCM, the peer review process is less comprehensive because such QCM is automatically tailored for the firm. [This answer is incorrect. When a firm uses its own internally developed QCM (and an independent QCM review has not been performed on it), the peer review team will have to assess the suitability of the QCM utilized, including the firm's system for developing and maintaining the QCM.]
 - c. Bridging documents only need a basic idea of the firm's QCM, as they do not need to be followed exactly. [This answer is incorrect. It is important for firms to tailor the bridging documents in their QCM to their engagement performance system. If firms are not following the bridging document as written, they should modify it to fit their own needs and procedures. Otherwise a peer review deficiency may result from failure to follow the firm's documented system.]
 - d. **It is important for QCM to be appropriate as it becomes an integral part of the firm's system of quality control. [This answer is correct. The use of QCM in a firm's accounting and auditing practice becomes an integral part of its system of quality control, especially in the area of engagement performance. Accordingly, it is important for a firm to ensure that the QCM being used is appropriate for its practice.]**
22. Typically, once a situation requiring consultation has been identified, what is the next thing that should be done? **(Page 99)**
- a. **The issue should be discussed amongst the engagement team. [This answer is correct. Once a situation requiring consultation is identified, the issue creating the need for consultation should be discussed with members of the engagement team.]**
 - b. Policies and procedures for consultations should be established. [This answer is incorrect. Establishing policies and procedures to ensure that consultation occurs when appropriate should occur *before* the need for an actual consultation has been identified.]
 - c. A specialist outside the firm should be selected. [This answer is incorrect. If the issue cannot be resolved within the firm, the engagement team should consult an outside source, such as an individual or another firm with the relevant specialized expertise. However, the engagement team should try other methods first and not go straight to an outside specialist.]
 - d. Document the nature and scope of the expected consultation. [This answer is incorrect. The last step in the consultation process is to document the nature and scope of consultations and the conclusions reached and implement the decision. Therefore, the consultation itself would need to be complete before it is documented.]
23. Which of the following is an engagement deficiency often noted in peer reviews? **(Page 101)**
- a. The auditor's report is qualified for a scope limitation. [This answer is incorrect. One such engagement deficiency is the *failure* to appropriately qualify an auditor's report for a scope limitation or departure from the basis of accounting used for the financial statements.]
 - b. An omission of the statement of cash flows in GAAP financial statements. [This answer is incorrect. An example of such a deficiency is the failure to *disclose* the omission of the statement of cash flows in financial statements prepared in accordance with GAAP.]

- c. Failure to include comparative GAAP references in reports on statements using other frameworks. [This answer is incorrect. One type of deficiency noted in peer review reports related to engagement performance is *inappropriate references* to GAAP in an accountant's report on financial statements prepared under a special purpose framework (e.g., cash or tax basis).]
- d. **The use of incorrect financial statement titles or terminology.** [This answer is correct. The majority of matters noted by peer reviewers arise during their review of specific engagements and most relate to the engagement performance element. One example of such a matter is reports that reflect financial statement titles and terminology that is not in accordance with professional standards.]

24. Which of the following is a consultation matter often noted in peer reviews? **(Page 108)**

- a. The consultation is documented in too much detail. [This answer is incorrect. One of the consultation-related matters commonly noted in peer reviews is the failure to document consultations that were performed.]
- b. **An incomplete firm library.** [This answer is correct. Two consultation matters often noted in peer reviews related to the firm library (which is part of the consultation process) is that the library is not utilized because staff is not comfortable with research, and the library does not contain appropriate technical manuals and guidance materials relative to the firm's practice and/or contains outdated versions.]
- c. Firm policy does not allow for enough consultation. [This answer is incorrect. One matter noted in peer reviews about consultation is the failure of an engagement team to consult when required by firm policy.]
- d. Consultations that take too long. [This answer is incorrect. One thing noted by peer reviewers about consultations is when they are insufficiently thorough and result in the wrong conclusion.]

EXAMINATION FOR CPE CREDIT

Companion to PPC's Guide to Quality Control—Course 1—Leadership Responsibilities and Engagement Performance (GQCTG221)

Testing Instructions

1. Following these instructions is an **Examination for CPE Credit** consisting of multiple choice questions. 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 those 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 the PDF and can be printed if needed.
2. **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 \$109 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.
3. **PRINT GRADING.** If you prefer, you may email, fax, or mail your completed answer sheet, as described below (\$109 for email or fax; \$119 for regular mail). The answer sheet is found at the end of the **Examination for CPE Credit**. Answer sheets may be printed from the PDF; they can also be scanned to send via email, if desired. Each answer sheet is identified with the course acronym. Please ensure you use the correct answer sheet for the course. 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
GQCTG221 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.

If you change your answer, remove your previous mark completely. Any stray marks on the answer sheet may be misinterpreted.

4. Each answer sheet sent for print grading must be accompanied by the appropriate payment (\$109 for answer sheets sent by email or fax; \$119 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 \$310 (a 5% discount on all three courses). If you complete four courses, the price for grading all four is \$392 (a 10% discount on all four courses). Finally, if you complete five courses, the price for grading all five is \$463 (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.

5. To receive CPE credit, completed answer sheets must be postmarked or entered into the Online Grading Center by **April 30, 2023**. CPE credit will be given for examination scores of 70% or higher.
6. When using our print grading services, only the **Examination for CPE Credit Answer Sheet** and the **Self-study Course Evaluation** should be submitted. **DO NOT SEND YOUR SELF-STUDY COURSE MATERIALS**. Be sure to keep a completed copy of the answer sheet for your records.
7. Please direct any questions or comments to our Customer Service department at (800) 431-9025 (Option 2).

EXAMINATION FOR CPE CREDIT

Companion to PPC's Guide to Quality Control—Course 1—Leadership Responsibilities and Engagement Performance (GQCTG221)

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 end of this course or accessed by logging onto the Online Grading System

1. Which of the following accurately describes the *tone at the top* concept?
 - a. Getting the job done on time is the primary goal of this concept.
 - b. It is the over-arching element for the other QC elements.
 - c. It is a very tangible concept.
 - d. It only provides direction to the top levels of staff.
2. What is at the core of an effective system of quality control?
 - a. A formal management style.
 - b. A conservative attitude.
 - c. Business strategy.
 - d. Integrity.
3. Which of the following makes it more likely that employees will follow the firm's code of conduct?
 - a. Introducing it in employee orientation.
 - b. Providing information about it orally.
 - c. Avoiding information about gray areas.
 - d. Management embracing the code.
4. Which of the following firms is actively promoting a positive working environment?
 - a. Red Sun Accounting offers salaries that are slightly below market level.
 - b. Malcolm & Simmons supports frequent turnover of its staff accountants.
 - c. Companion CPAs uses a team approach and fosters a collaborative atmosphere.
 - d. Persephone Auditors sets unrealistic goals to force employees to stretch.
5. When firm management discovers noncompliance with its quality control policies and procedures or its ethics rules, it should do which of the following?
 - a. Respond in a timely manner.
 - b. Conduct a cursory investigation.
 - c. Loosen the controls around the problem area.
 - d. Keep the noncompliance and the response quiet.

6. The overall objective for a firm's accounting and auditing practice, which is reflected by the assignment of management responsibilities, should be which of the following?
 - a. Selling services.
 - b. Performing quality engagements.
 - c. Establishing compensation and incentive systems.
 - d. Profitability of the firm.
7. Which of the following actions by firm leadership related to evaluation, compensation, and advancement, illustrates the firm's commitment to quality?
 - a. Performance evaluations are performed when there is a lull in engagements.
 - b. Staff members must justify spending more than the allotted time on engagement issues.
 - c. Partners are rewarded monetarily when they complete engagements quickly.
 - d. The resumes of new recruits emphasize academics, service, and learning.
8. Who would most likely oversee a firm's independence, integrity, and objectivity matters?
 - a. The AICPA audit quality center partner.
 - b. The ethics partner.
 - c. The peer reviewer.
 - d. The recruitment and hiring manager.
9. Which of the following contains illustrated policies and procedures, as well as implementation tips, warnings, and reminders to help a firm develop its quality control system?
 - a. *Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice* (the AICPA Practice Aid).
 - b. The AICPA *Peer Review Program Manual* (PRPM).
 - c. QC 10, *A Firm's System of Quality Control*.
 - d. COSO's *Internal Control over External Financial Reporting: A Compendium of Approaches and Examples*.
10. How should a firm's quality control system be developed?
 - a. QC policies should be the same for all firms despite their size or complexity.
 - b. Policies support the system, and procedures support the stated policies.
 - c. The knowledge and experience of personnel should not influence the QC policy.
 - d. Firms must follow the specific guidance in the AICPA Practice Aid.
11. What is different about the leadership responsibilities element of quality control?
 - a. It is easier to understand and deal with than the other elements of quality control.
 - b. It is more tangible than the other elements of quality control.
 - c. It is significant because it provides the basis for an effective system of quality control.
 - d. Peer reviewers seldom find or note matters related to this element of quality control in their reports.

12. Why is designing the engagement performance element of a quality control system complex?
- It is self-contained and does not involve the other elements of quality control addressed in the system.
 - It must cover all types of accounting and auditing engagements and interface with related materials used by the firm.
 - It is the overarching element that forms the basis for all other quality control elements addressed in the system.
 - To perform engagements accurately, the firm's system must provide a unique approach instead of one that is standardized.
13. What is necessary before starting the process of designing engagement performance, supervision, and review policies and procedures that fit a firm's practice?
- There must be a familiarity with the authoritative guidance under which engagements are performed.
 - The quality control system must be designed to differentiate between service levels according to SQCS No. 8.
 - The plan for designing policies and procedures must be designed independently from other types of authoritative literature.
 - Ideas for policies and procedures must be simplified since engagement performance contains fewer requirements than other QC elements.
14. According to QC 10, which of the following individuals has properly performed a task associated with engagement supervision?
- Steve designs the engagement approach, but does not track the progress.
 - Tasha modifies the engagement approach to address significant findings.
 - James cancels an important consultation because his team does not have time to complete it.
 - Darcy assigns a complex, problematic consultation to a new team member with little experience.
15. What are the six fundamental principles of professional ethics outlined in the AICPA's *Code of Professional Conduct* (the Code)?
- | | |
|---------------------------------|----------------------------------|
| i. Due care | vi. Objectivity and independence |
| ii. Tone at the top | vii. Quality control |
| iii. The public interest | viii. Integrity |
| iv. Engagement performance | ix. Responsibilities |
| v. Scope and nature of services | |
- i., ii., iii., v., vi., and ix.
 - i., iii., v., vi., viii., and ix.
 - i., iv., vi., vii., viii., and ix.
 - ii., iii., iv., v., vi., and viii.

16. When performing nonattest services for attest clients, a practitioner must do which of the following?
- a. In a verbal agreement, make sure that the client clearly understands the services provided and who is responsible for what.
 - b. Be satisfied that the client will assume all management responsibilities for the service and oversee the service.
 - c. Perform multiple nonattest services for each client.
 - d. Provide limited information about attest clients obtaining nonattest services to peer reviewers so as to maintain confidentiality.
17. When an engagement partner reviews work under AU-C 220, which of the following is required?
- a. The review should be performed after the date of the auditor's report.
 - b. Documentation about critical areas of judgment should be targeted.
 - c. Engagement partners must omit the names of staff who assist with the review for confidentiality reasons.
 - d. Once assigned, the engagement partner in charge of the review cannot be changed.
18. What information is provided in AR-C 60?
- a. Engagement performance requirements for attestation services.
 - b. Emphasized guidance on audit documentation quality requirements.
 - c. Acceptance and continuance quality control policies and procedures.
 - d. Engagement-level QC requirements for engagement partners performing SSARS engagements.
19. A firm's quality control system for engagement performance should be—
- a. devoted to a single type of engagement.
 - b. integrated with other elements of quality control.
 - c. separate from accounting and auditing materials.
 - d. the same regardless of a firm's size.
20. When might a firm need a consultation?
- a. They encounter a complicated technical issue.
 - b. The client is typical of its industry.
 - c. The firm is large and has in-house specialists.
 - d. The firm is performing an audit engagement.
21. Outside consultation is often more normal for what type of firm?
- a. A large firm.
 - b. A small firm.
 - c. An audit firm.
 - d. A compilation and review firm.

22. How do the various authoritative standards treat consultation?
- a. Consultations are specifically required by the SSARS for compilation and review engagements.
 - b. AU-C 220 places responsibility on the engagement partner to ensure appropriate consultation is obtained.
 - c. AT-C 105 makes one requirement for consultation that also has an effect on accounting and auditing engagements.
 - d. The guidance for using specialists, as outlined in the audit and attestation standards, does not specifically apply during consultations.
23. In which of the following engagements would a consultation most likely be needed?
- a. Guardian Inc. maintains the same generally accepted accounting principles it uses every year.
 - b. Milo Limited's auditor does not find evidence of fraud during the audit.
 - c. Shield Group's accounting estimates are not uncertain as of the financial statement date.
 - d. The auditor's report on Hammer Industries must be reissued after new facts are discovered.
24. Which of the following statements most accurately describes the documentation needed for differences of opinion?
- a. Specific documentation requirements in QC 10 must be met when there is a difference of opinion.
 - b. Policies and procedures related to such documentation must be strict and detailed for appropriate records.
 - c. It is a best practice to document material matters, but not those that are minor or more general.
 - d. Special audit requirements exist that must be followed for differences of opinion even if they differ from firm policies and procedures.
25. Engagement quality control reviews (EQCRs) are performed—
- a. on all engagements performed by the firm.
 - b. on all accounting and auditing engagements performed by the firm.
 - c. on engagements for which the firm has determined EQCRs are required.
 - d. on random, handpicked engagements if engagement partners think EQCR is warranted.
26. According to QC 10.41, the firm's EQCR policies and procedures should include which of the following?
- a. Discussing significant findings and issues with the entire engagement team and management.
 - b. Reading the financial statements, other subject matter information, and the proposed report.
 - c. Reviewing all of the documentation compiled by the engagement team for that engagement.
 - d. Interviewing client management as to whether the proposed report and associated conclusions are appropriate.

27. Which of the following is a common mistake firms make related to EQCRs?
- a. Using an engagement partner's preissuance review as the EQCR.
 - b. Performing EQCRs before the engagement report is issued.
 - c. Performing EQCRs only on engagements that meet the specified criteria.
 - d. Assigning someone who is competent in auditing and accounting to perform EQCRs.
28. When might an engagement quality control reviewer need to be replaced?
- a. The assigned reviewer becomes too busy to perform the EQCR.
 - b. A disagreement occurs between the reviewer and the engagement partner.
 - c. The reviewer's ability to perform an objective EQCR has been impaired.
 - d. Once assigned, the reviewer cannot be replaced without invalidating the EQCR.
29. A firm's quality control policies and procedures should require what in relation to the assembly of engagement documentation?
- a. That engagement teams should finalize all documentation within 30 days of the report release date.
 - b. That engagement teams should finish assembling documentation in a timely manner, whether or not time limits are prescribed by standards.
 - c. That engagement teams dealing with multiple reports should combine them as part of the same engagement.
 - d. That engagement teams use unique organization and indexing for each engagement to ensure quality.
30. A firm's policies and procedures for engagement documentation should do which of the following?
- a. Ensure that engagement documentation is retained for a maximum of one year, as required by AU-C 230.
 - b. Require firms to store their engagement documentation electronically to promote paperless offices.
 - c. Ensure that engagement documentation access is unrestricted so new firm members can make changes for training purposes.
 - d. Establish controls that stop engagement documentation from being altered, deleted, or added to without the firm's knowledge.
31. Why might it be extra important for firms to consult PRPM when designing the engagement performance quality control system?
- a. This quality control element is given close scrutiny during peer review.
 - b. Peer reviewers are less likely to review documentation about this quality control element.
 - c. It includes illustrative policies and procedures provided by the AICPA.
 - d. Use of PRPM means the firm's policies and procedures will not need to be changed.

32. What could happen if a firm puts every quality control step taken during a normal engagement in the quality control document?
- a. The document will be easier to understand.
 - b. The document will be nuanced for all engagement types.
 - c. The document will be too long and hard to understand.
 - d. The document will take the place of the firm's quality control materials.
33. What is a best practice for assigning responsibilities for completing engagement-level quality control steps in a bridging document?
- a. Assign all quality control steps to the engagement partner.
 - b. Refer to the authoritative guidance for requirements on assigning steps.
 - c. Indicate whether steps are assigned to the partner, another in-charge person, or the engagement team.
 - d. Assign all quality control steps to new staff members.
34. An integral part of a firm's QC system, checklists, work programs, sample letters, and other aids that assist firms with performing and reporting under professional standards are often called what?
- a. Bridging documents.
 - b. Engagement documentation.
 - c. AICPA illustrative procedures.
 - d. Quality control materials (QCM).
35. Who is responsible for the reliability and suitability of QCM a firm purchases from a third party?
- a. The users of the QCM.
 - b. The third-party provider.
 - c. The AICPA.
 - d. The peer reviewer.
36. When a firm uses QCM purchased from a third party, it should perform all of the following procedures **except**:
- a. Consulting the third party's website periodically for new or corrected materials when unusual changes might be needed.
 - b. Reviewing the QCM at the time of its initial purchase, as well as when updated materials are purchased or received.
 - c. Use the materials as they come from the third-party provider without alterations or supplements.
 - d. Integrate the third-party QCM into the firm's engagement performance system.

37. The CPA firm of Rogers & Barnes uses QCM purchased from a third party. The third party's QCM has been peer reviewed, but it received a *fail* rating. How will this affect the firm's peer review?
- a. The firm's peer reviewer can safely assume that the firm's engagement methodology is appropriate.
 - b. The firm's peer reviewer can automatically rely on the QCM to be appropriate for the firm's system of quality control.
 - c. The firm's peer reviewer will have to perform additional work to determine whether the QCM's deficiencies affect the firm's quality control system.
 - d. If the firm has significantly modified the QCM, the third-party provider's peer review results will not be important to the firm's peer review.
38. The design of the firm's engagement performance QC system should do which of the following related to consultation?
- a. Encourage engagement teams to forego consultation when possible.
 - b. Allow a voice for a minority opinion within the consultation.
 - c. Avoid designing a documentation policy for consultations.
 - d. Establish rigid documentation requirements with no flexibility.
39. How might a firm's EQCR be affected if an engagement is more complex or higher risk than normal?
- a. The EQCR will not change from the requirements set in the quality control policies and procedures.
 - b. The firm may choose to expand the extent of the review or include additional procedures.
 - c. The assigned engagement quality control reviewer will need to be replaced.
 - d. Requirements prohibit firms from performing additional procedures.
40. Which of the following is an engagement performance error or deficiency related to disclosure often noted in peer reviews?
- a. Disclosures that are too detailed.
 - b. Failure to disclose ten years of debt maturities.
 - c. Including subsequent events disclosures related to COVID-19.
 - d. Failure to disclose the cumulative effect of changing an accounting principle.

EXAMINATION FOR CPE CREDIT ANSWER SHEET

Companion to PPC's Guide to Quality Control—Course 1—Leadership Responsibilities and Engagement Performance (GQCTG221)

Name: _____

Firm Name: _____

Firm Address: _____

City: _____ State/ZIP: _____

Firm Phone: _____ Firm Fax No.: _____

Firm Email: _____

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Credit Card Number: _____ Expiration Date: _____

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ANSWERS:

This answer sheet and the following evaluation can be printed. If filling out a printed version, please indicate your answers 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 \$109 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 \$109; the price for answer sheets sent by regular mail is \$119.

Expiration Date: April 30, 2023

Self-study Course Evaluation

Please Print Legibly—Thank you for your feedback!

Course Title: Companion to PPC’s Guide to Quality Control—Course 1—Leadership Responsibilities and Engagement Performance (GQCTG221)

Your Name (optional): Date:

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Please indicate your answers by filling in the appropriate circle as shown:
Fill in like this: not like this:

Satisfaction Level:	Low (1) . . . to . . . High (10)									
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GLOSSARY

AICPA Practice Aid: This guidance (*Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice*) provided by the AICPA can be used as a tool to help practitioners develop the policies and procedures that comprise a firm's system of quality control. It includes illustrative policies and procedures, as well as tips, warnings, and reminders for implementing the policies and procedures.

Bridging document: A worksheet that shows the engagement performance quality control steps performed by the firm for each type of engagement. It allows the firm to tailor its procedures to fit the type of engagement and to interface its quality control document into the checklists, forms, and practice aids used by the firm.

Code of conduct: A written document that allows firm management to effectively communicate the firm's ethical values and standards.

Consultation: Conferring with individuals who possess relevant specialized expertise at the appropriate professional level (either inside the firm or outside of it) when the engagement team encounters complex technical issues or unique industry situations that it has never encountered before.

Engagement performance: One of the elements of quality control. The quality control system that addresses this element should encompass the unique planning, performing, supervision, reviewing, documenting, and communicating decisions that occur on each engagement. It needs to be flexible enough to address all accounting and auditing engagements and needs to interface with the accounting and auditing materials used by the firm. It should also consider the policies and procedures for the other quality control elements.

Engagement quality control review (EQCR): A process designed to provide an objective evaluation, before the report is released, of the significant judgments made by the engagement team and the conclusions the engagement team reached in formulating the report. EQCR is only performed for those engagement for which the firm has determined one is required, as documented in the firm's quality control policies and procedures.

Engagement team: All nonpartner staff assigned to the engagement team.

Ethics partner: An individual in the firm with the responsibility for overseeing firm personnel compliance with ethical requirements. This generally includes overseeing the administration of all firm independence-related matters, as well as integrity and objectivity issues.

Leadership responsibilities for quality within the firm: This is the first element of a system of quality control and an over-arching element for the other QC elements. One of the most successful ways to establish and maintain a high level of quality within a firm is through the example set by firm leadership. When firm leadership considers the ethical and quality aspects of a situation as part of its decision-making process, others in the firm will also be more likely to do so.

Quality control director: An individual within the firm who is selected to lead the quality control effort. He or she must be given sufficient authority and adequate time and assistance to succeed. This person should have (1) technical expertise, (2) a high level of personal commitment to quality, (3) a first-hand knowledge of the firm, and (4) a track record of accomplishments.

Quality control materials (QCM): The engagement work programs, checklists, sample confirmations and letters, and other practice aids used by a firm. This system of practice aids is an integral part of a firm's QC system.

Reasonable assurance: A high, but not absolute, level of assurance.

Recruitment and hiring manager: The individual in the firm responsible for staffing decisions. They have a responsibility to hire individuals who display the traits and abilities the firm desires in its professional employees, such as a commitment to quality.

Suitably qualified external person: An individual outside the firm who possesses the competence and capabilities to act as an engagement partner (e.g., a partner of another firm).

Tone at the top: A firm's culture, which is defined by the actions and verbal and nonverbal messages conveyed by those individuals who comprise firm leadership to everyone with whom they come into contact, both internal and external to the firm. It includes (1) a standard set by firm leadership against which all performance is measured, (2) the ambient culture, (3) the force that impacts behavior in spite of actual documented policies, (4) an unseen hand that guides the behavior of partners and staff when no one is looking, and (5) the level of commitment to quality of client service.

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COMPANION TO PPC'S GUIDE TO QUALITY CONTROL

COURSE 2

ETHICAL REQUIREMENTS AND CLIENT ACCEPTANCE AND CONTINUANCE
(GQCTG222)

OVERVIEW

COURSE DESCRIPTION:	This interactive self-study course looks at two issues related to a firm's quality control system. Lesson 1 discusses relevant ethical requirements, including independence, and how they affect the firm. Lesson 2 focuses on the firm's acceptance and continuance of client relationships and specific engagements.
PUBLICATION/ REVISION DATE:	April 2022
RECOMMENDED FOR:	Users of <i>PPC's Guide to Quality Control</i>
PREREQUISITE/ ADVANCE PREPARATION:	Basic knowledge of quality control
CPE CREDIT:	7 NASBA Registry "QAS Self-Study" Hours This course is designed to meet the requirements of the <i>Statement on Standards of Continuing Professional Education (CPE) Programs</i> (the <i>Standards</i>), issued jointly by NASBA and the AICPA. As of this date, not all boards of public accountancy have adopted the <i>Standards</i> in their entirety. For states that have adopted the <i>Standards</i> , 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 <i>Standards</i> .
FIELD OF STUDY:	Business Management & Organization
EXPIRATION DATE:	Postmark by April 30, 2023
KNOWLEDGE LEVEL:	Basic

Learning Objectives:

Lesson 1—Relevant Ethical Requirements

Completion of this lesson will enable you to:

- Identify the ethical requirements that are relevant to CPA firms.
- Identify independence requirements and how they affect a firm's quality control system.
- Recognize appropriate quality control policies and procedures related to ethical requirements and how to evaluate the adequacy of the firm's quality control system.

Lesson 2—Acceptance and Continuance of Client Relationships and Specific Engagements

Completion of this lesson will enable you to:

- Determine best practices for evaluating client acceptance and continuance issues, including competence and capabilities, compliance with legal and ethical requirements, the client's integrity, and other considerations.
- Recognize how to obtain the client's agreement on engagement terms, withdraw from the engagement, prepare appropriate quality control policies and procedures, and evaluate the adequacy of the firm's quality control system.

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Lesson 1: Relevant Ethical Requirements

INTRODUCTION

The second element of quality control is relevant ethical requirements. The term *relevant ethical requirements*, as defined by SQCS No. 8, *A Firm's System of Quality Control*, at QC 10.13, represents ethical requirements the firm and its personnel are subject to. Such requirements consist of the AICPA *Code of Professional Conduct* and rules of applicable state boards of accountancy and regulatory agencies that may be more restrictive. While this definition refers to all ethical requirements to which a firm may be subject, SQCS No. 8 (QC 10) primarily discusses the ethical requirement of independence.

Throughout this course, the authors use the phrase *relevant ethical requirements* and *ethical requirements* interchangeably to refer to the second element required by QC 10 to be addressed within the firm's quality control system policies and procedures.

This lesson focuses on providing an understanding of how relevant ethical requirements affect quality control, emphasizing independence; addresses the requirements of QC 10 for how firms maintain those ethical requirements; and provides information on drafting the firm's quality control policies and procedures, customized for the firm's size and structure.

Learning Objectives:

Completion of this lesson will enable you to:

- Identify the ethical requirements that are relevant to CPA firms.
- Identify independence requirements and how they affect a firm's quality control system.
- Recognize appropriate quality control policies and procedures related to ethical requirements and how to evaluate the adequacy of the firm's quality control system.

Authoritative Literature

This lesson provides information to assist firms in understanding and complying with the authoritative literature that addresses relevant ethical requirements as part of the firm's system of quality control pursuant to QC 10. Additionally, the auditing, attestation, and SSARS 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, *Concepts Common to All Attestation Engagements*, provides criteria that a firm should satisfy in order to accept an attestation engagement, including ensuring that relevant ethical requirements will be adhered to. AT-C 105 further provides guidance indicating that the engagement partner should take responsibility for overall quality on each attestation engagement performed. AR-C 60, *General Principles for Engagements Performed in Accordance with Statements on Standards for Accounting and Review Services*, provides guidance specific for SSARS engagements, focusing on the engagement partner and engagement team.

Thus, the authoritative literature of the *Code of Professional Conduct*, SASs, SSAEs, and SSARS all provide guidance that addresses the firm adhering to ethical requirements of the AICPA. Additionally, a firm is expected to follow the ethical requirements of relevant state boards of accountancy and state societies of CPAs. If firms provide services under the regulations of regulatory agencies, such as the GAO and DOL, the ethical requirements stipulated by those agencies also should be met. Such information is discussed throughout this lesson.

Requirements

The requirements pursuant to the authoritative literature discussed in the previous paragraph that relate to relevant ethical requirements are detailed in Exhibits 1-1 through 1-4.

Exhibit 1-1

Requirements for Relevant Ethical Requirements QC Policies and Procedures under QC 10

Requirements	QC 10
Relevant Ethical Requirements	
The firm should establish policies and procedures designed to provide reasonable assurance that the firm and its personnel comply with relevant ethical requirements.	QC 10.21
<i>Independence</i>	
Such policies and procedures should provide the firm with reasonable assurance that the firm, its personnel, and others subject to independence requirements (including network firm personnel) maintain independence when required to do so. Such policies and procedures should enable the firm to— <ul style="list-style-type: none"> • Communicate independence requirements to its personnel and others subject to them. • Identify and evaluate threats to independence. • Take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards. Appropriate action includes withdrawing from the engagement when necessary. 	QC 10.22
Policies and procedures related to maintaining independence should require— <ul style="list-style-type: none"> • Engagement partners to provide relevant information about client engagements to allow the firm to evaluate the overall effect on independence requirements. • Personnel to promptly notify the firm of threats to independence so that appropriate action can be taken. • Accumulation and communication of relevant information to appropriate personnel so that the firm and its personnel (1) can readily determine whether independence requirements are satisfied; (2) can maintain and update independence information; and (3) can take appropriate action when threats to independence are not at an acceptable level. 	QC 10.23
The firm should establish policies and procedures to provide reasonable assurance that it is notified of breaches of independence requirements and to enable it to take appropriate actions to resolve such situations. These policies and procedures should include requirements for— <ul style="list-style-type: none"> • Personnel to promptly notify the firm of independence breaches. • The firm to promptly communicate breaches of these policies and procedures to (1) the engagement partner who needs to address the breach and (2) other relevant personnel in the firm (and the network, when appropriate) who need to take appropriate action. • Prompt communication to the firm by those who have taken action to resolve the matter so that the firm can determine whether further action should be taken. 	QC 10.24

Requirements	QC 10
The firm should obtain, at least annually, written confirmation of compliance with its policies and procedures on independence from all firm personnel who are required to be independent.	QC 10.25
The firm should establish policies and procedures for all audit and attestation engagements for which regulatory or other authorities require rotation of personnel.	QC 10.26

Exhibit 1-2

Requirements for Relevant Ethical Requirements QC Procedures under AU-C 220

Requirements	AU-C 220
Relevant Ethical Requirements	
The engagement partner and other members of the engagement team should remain alert for evidence of noncompliance with relevant ethical requirements by members of the engagement team.	AU-C 220.11
If there is indication that members of the engagement team have not complied with relevant ethical requirements, the engagement partner, in consultation with others in the firm as appropriate, should determine that appropriate action has been taken.	AU-C 220.12
Independence	
<p>The engagement partner should form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, the engagement partner should—</p> <ul style="list-style-type: none"> Obtain relevant information from the firm (and, when applicable, network firms) to identify and evaluate circumstances and relationships that create threats to independence. Evaluate information that a breach of the firm's independence policies and procedures has occurred and determine whether the situation creates a threat to independence for the audit. Take appropriate action to eliminate any identified threats or to reduce them to an acceptable level by applying safeguards. Report any inability to resolve the matter promptly to the firm so that it may take appropriate action. 	AU-C 220.13
Documentation	
<p>Audit documentation should include—</p> <ul style="list-style-type: none"> Identification of any relevant ethical requirements issues and how such issues were resolved. 	AU-C 220.25a
<ul style="list-style-type: none"> Conclusions made to comply with the independence requirements that apply to the engagement and any relevant discussions with the firm that support those conclusions. 	AU-C 220.25b

Exhibit 1-3**Attestation Engagement-level QC Requirement under AT-C 105**

Requirement	AT-C 105
The practitioner should accept an attestation engagement only when certain criteria are met, including having no reason to believe that relevant ethical requirements, including independence, will not be satisfied.	AT-C 105.29(a)
After implementation of SSAE No. 21: The engagement partner should remain alert for evidence of noncompliance with relevant ethical requirements by members of the engagement team. If there is an indication that members of the engagement team have not complied with relevant ethical requirements, the engagement partner, in consultation with others in the firm, should determine that appropriate action is taken.	AT-C 105.36

Exhibit 1-4**SSARS Engagement-level QC Requirement under AR-C 60**

Requirement	AR-C 60
The engagement partner should remain alert for evidence of noncompliance with relevant ethical requirements by members of the engagement team. If there is an indication that members of the engagement team have not complied with relevant ethical requirements, the engagement partner, in consultation with others in the firm, should determine that appropriate action is taken.	AR-C 60.23

A DISCUSSION OF THE RELEVANT ETHICAL REQUIREMENTS**Overall QC 10 Requirement**

QC 10.21 stipulates an overarching requirement for firms to establish policies and procedures designed to provide reasonable assurance that the firm and its personnel comply with relevant ethical requirements. Detailed information about the many aspects of relevant ethical requirements is provided throughout this lesson.

AU-C 220 Requirements

AU-C 220 includes guidance for the QC element of relevant ethical requirements. AU-C 220.11–.12 require all members of the audit engagement team to remain alert throughout the engagement for any evidence of noncompliance with relevant ethical requirements by members of the engagement team. If matters come to the engagement partner's attention that members of the engagement team have not complied with relevant ethical requirements, the engagement partner and other appropriate individuals in the firm should determine that appropriate action is taken. Additionally, AU-C 220.25 indicates that the engagement partner should include in the audit documentation the issues identified and how they were resolved.

AT-C 105 Requirements

AT-C 105 also provides guidance relating to relevant ethical requirements. AT-C 105.29 indicates that the practitioner should accept an attestation engagement only when certain criteria are met, including having no reason to believe that relevant ethical requirements, including independence, will not be satisfied.

SSAE No. 21 added a new paragraph at AT-C 105.36, which requires the engagement partner to be alert throughout the engagement for evidence of noncompliance by anyone on the engagement team. The engagement partner remains alert for noncompliance through observation and by making inquiries as necessary. If matters come to the

engagement partner's attention that anyone on the engagement team is not in compliance with relevant ethical requirements, the engagement partner, in consultation with others in the firm, should determine that appropriate action is taken. This new requirement for attestation engagements is like the requirements in AU-C 220.11–.12 and AR-C 60.23 for auditing and SSARS engagements, which are also discussed in this section. This requirement is effective when the firm implements SSAE No. 21.

AR-C 60 Requirements

AR-C 60, among other things, provides engagement-level quality control requirements for the engagement partner. The engagement-level quality control requirements of AR-C 60.20–.24 include several of the QC elements found in QC 10, one of which is relevant ethical requirements.

AR-C 60.23 requires the engagement partner to be alert throughout the engagement for evidence of noncompliance by anyone on the engagement team. The engagement partner remains alert for noncompliance through observation and by making inquiries as necessary. If matters come to the engagement partner's attention that anyone on the engagement team is not in compliance with relevant ethical requirements, the engagement partner, in consultation with others in the firm, should determine that appropriate action is taken.

The Code and Its *Conceptual Framework for Members in Public Practice*

The Code (section ET in the AICPA *Professional Standards*) applies to all members of the AICPA, whether in public practice, business (for example, industry, government, education, the nonprofit sector, or regulatory or professional bodies), unemployed, or retired, although not all parts of it apply to all of those membership segments. A member in public practice who has the authority or capacity to control other individuals might be held responsible for their acts. Furthermore, other individuals should not knowingly be allowed to perform acts on the member's behalf (whether or not for compensation) if such acts would be a violation of the Rules if performed by the member. Additionally, certain requirements of the Code relating to attest engagements where independence is mandatory, apply to covered members. Information about the many Rules and Interpretations of the Code is provided later in this section.

The Code includes two overarching conceptual frameworks: one for members in public practice and one for members in business. Only the framework for members in public practice is discussed in this course. Although the Code's Rules and Interpretations address many situations, that guidance cannot address all relationships or circumstances that may arise. When there is not an interpretation that addresses a member's particular relationship or circumstance, the *Conceptual Framework for Members in Public Practice* (ET 1.000.010) should be used to identify threats to a member's compliance with the Rules and to evaluate identified threats, both individually and in the aggregate.

When using the *Conceptual Framework for Members in Public Practice*, the member should evaluate whether the relationship or circumstance would lead a reasonable and informed third party who is aware of the relevant information to conclude that there is an unacceptable threat to the member's compliance with the Rules. The *Conceptual Framework for Members in Public Practice* (Conceptual Framework) provides overarching guidance for Part 1 of the Code. In fact, every topic in Part 1 of the Code requires members to apply the Conceptual Framework in the absence of an interpretation that addresses the particular relationship or circumstance. (Under ET 1.000.010.03, however, members should apply the *Conceptual Framework for Independence Interpretation* at ET 1.210.010 instead of the Conceptual Framework when making decisions on independence matters that are not explicitly addressed by the *Independence Rule* and its interpretations)

Applying the Conceptual Framework is a three-step process in which the member should (ET 1.000.010.07)—

- a. Identify threats to compliance with the Rules.
- b. Evaluate the significance of identified threats, individually and in the aggregate, considering both qualitative and quantitative factors.
- c. Identify and apply safeguards to eliminate unacceptable threats or to reduce them to an acceptable level.

Those steps are discussed in the next few paragraphs.

Identify Threats to Compliance with the Rules. When faced with a relationship or circumstance that is not specifically addressed by a Rule or an Interpretation, a member should determine whether the relationship or circumstance creates any threats to complying with the Rules. The Conceptual Framework specifies the following seven broad categories of threats:

- Adverse interest threat.
- Advocacy threat.
- Familiarity threat.
- Management participation threat.
- Self-interest threat.
- Self-review threat.
- Undue influence threat.

The threats are discussed in more detail below.

Evaluate the Significance of Threats. An identified threat does not automatically mean there is a violation of the Rules. The significance of the threat should be evaluated to determine whether it is at an acceptable level. Threats should be evaluated, both individually and in the aggregate, considering both qualitative and quantitative factors, including the extent to which existing safeguards already reduce the threat to an acceptable level.

Identify and Apply Safeguards to Unacceptable Threats. If a threat is not at an acceptable level, safeguards should be applied to eliminate the threat or reduce it to an acceptable level. Because the effectiveness of safeguards depends on the circumstances, judgment should be applied when determining the nature of the safeguards to be applied. It may be necessary to apply multiple safeguards to a given threat. The Conceptual Framework specifies three broad categories of safeguards, as follows:

- Safeguards created by the profession, legislation, or regulation.
- Safeguards implemented by the firm, including policies and procedures for implementing professional and regulatory requirements.
- Safeguards implemented by the client.

The safeguards are discussed in more detail later in this section.

After applying appropriate safeguards, the member may proceed with the professional service if the firm has concluded that the identified threats are now at an acceptable level. The AICPA recommends that the firm document the identified threats and safeguards applied.

Some threats may be so significant that (a) no safeguards will eliminate them or reduce them to an acceptable level or (b) effective safeguards may not be able to be implemented. When that is the case, providing professional services would compromise compliance with the Rules. The firm should determine whether to decline or discontinue the professional services or resign from the engagement.

In addition, the Code specifies certain circumstances in which no safeguards can reduce a threat to an acceptable level. When that is the case, the Conceptual Framework may not be used to overcome a prohibition or requirement specifically contained in the Code. For example, it may not be used to overcome the prohibition against subordinating professional judgment to others.

Threats to Compliance with the Rules. The broad categories of threats and related examples provided in the Code are located at ET 1.000.010.10–.16. The following information describes each type of threat and includes one of the related examples—

- *Adverse Interest Threat*—Whether the member will not act with objectivity because the member's interests and those of the client are in opposition. For example, the client has expressed intent to commence litigation against the member.
- *Advocacy Threat*—Whether a member's objectivity or independence is compromised due to promoting a client's interests or position. For example, the member provides forensic accounting services to a client in litigation or a third-party dispute.
- *Familiarity Threat*—Whether a member will become too sympathetic to a client's interests or too accepting of the client's work or product due to having a long or close relationship with the client. For example, the client employs immediate family, a close relative, or a close friend of the member. [PEEC has issued two Frequently Asked Questions (FAQs) addressing (1) whether the familiarity threat to independence increases when senior personnel of the engagement team have been on the attest engagement team for a long period of time and the relevant factors to consider when making that determination; and (2) whether the firm can still perform the attest engagement if it has been determined that there is a significant familiarity threat to the *Independence Rule* because senior personnel have served on the attest engagement team for a long period of time, and examples of safeguards that may be applied to eliminate the threat or reduce it to an acceptable level. The FAQs are available at us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-general-faqs.pdf.]
- *Management Participation Threat*—Whether a member will function as a client's management or otherwise assume management responsibilities for a client; for example, this can occur when providing nonattest services.
- *Self-interest Threat*—Whether a member could benefit, financially or otherwise, from an interest in or relationship with a client or individuals associated with the client. For example, the fair value of the member's financial interest in the client may be affected by the outcome of a professional services engagement.
- *Self-review Threat*—Whether a member (a) will not appropriately evaluate the results of a judgment made or service performed or supervised by the member or someone else in the firm and (b) will rely on that service when making a judgment as part of another service. For example, the member relies on the firm's work product.
- *Undue Influence Threat*—Whether a member will subordinate their judgment to that of someone associated with a client or any relevant third party due to that person's reputation, expertise, aggressive or dominant personality, or attempts to coerce or exercise excessive influence over the member. For example, the client threatens to dismiss the firm.

Safeguards. The broad categories of safeguards and related examples provided in the Code are located at ET 1.000.010.21–.23. The following information lists just a few of the many examples provided in the Code for each type of safeguard—

- *Safeguards Created by the Profession, Legislation, or Regulation.* For example—
 - Education, training, and CPE requirements related to independence and ethics.
 - External review of the firm's quality control system.
- *Safeguards Implemented by the Firm.* Such safeguards include policies and procedures for implementing professional and regulatory requirements. For example—
 - Firm leadership stresses the importance of complying with the Rules and the expectation that engagement teams will act in the public interest.

- Documented policies for identifying threats, evaluating their significance, and identifying and applying safeguards that can eliminate the threats or reduce them to an acceptable level.
- Partners and professional staff are trained on, and receive timely communication about, the firm's policies and procedures, including changes to them.
- A member of senior management is designated to oversee the firm's quality control system.
- A process exists for informing partners and professional staff of attest clients and related entities for which independence is required.
- A disciplinary mechanism is designed to promote compliance with policies and procedures.
- *Safeguards Implemented by the Client.* For example—
 - Client personnel with suitable skill, knowledge, or experience make managerial decisions with respect to professional services and consult third-party resources when necessary.
 - The *tone at the top* emphasizes the client's commitment to fair financial reporting and compliance with applicable laws, rules, regulations, and corporate governance policies.

The Code states that members may not rely solely on safeguards implemented by the client to eliminate significant threats or reduce them to an acceptable level. Client-implemented safeguards have to operate in combination with other safeguards.

Ethical Conflicts. An ethical conflict arises when a member encounters obstacles that prevent the member following an appropriate course of action due to internal or external pressures and/or conflicts in applying relevant professional standards or legal standards. For example, a member may suspect that fraud has occurred, but reporting the suspected fraud would violate the member's responsibility to maintain client confidentiality. (The preceding example is removed by ethics interpretation ET 1.170.010, *Responding to Noncompliance With Laws and Regulations*, once it becomes effective.) ET 1.000.020 addresses ethical conflicts.

Each topic in Part 1 of the Code stipulates that members are required to consider the *Ethical Conflicts* guidance in addressing ethical conflicts that may arise as the member tries to follow an appropriate course of action. Thus, when members are looking at any individual topic within the Code, it is apparent that the *Ethical Conflicts* guidance is to be considered if obstacles are encountered in following an appropriate course of action.

If an ethical conflict is encountered, a member may be required to take steps to achieve compliance with the rules and legal requirements. When deciding between alternative courses of action, factors such as the following should be considered:

- The relevant facts and circumstances, including applicable rules, laws, or regulations.
- The ethical issues involved.
- Established internal procedures.

The member should be prepared to justify any departures that they believe were appropriate in applying the relevant rules, laws, and regulations. Furthermore, the member may have to address the consequences of the violations of applicable rules, laws, or regulations.

Before acting to resolve an ethical conflict, the member should consider consulting with appropriate persons within the firm. If the member decides not to consult with such persons and the conflict remains unresolved after pursuing the selected course of action, the member should consider either (a) consulting with other individuals to help resolve the issue or (b) obtaining advice from an appropriate professional body or legal counsel. The member should also consider documenting the substance of the issue, the parties with whom it was discussed, details of the discussions, and decisions reached. If the ethical conflict remains unresolved, the member should consider whether to continue their relationship with the engagement team, specific assignment, client, firm, or employer.

AICPA Conceptual Framework Toolkit for Members in Public Practice. The AICPA provides a toolkit to assist members in implementing the Conceptual Framework. The toolkit includes, among other things, a worksheet to assist with applying the steps of the conceptual framework that could be used to document a firm's assessment of an ethical issue. The toolkit is available at us.aicpa.org/InterestAreas/ProfessionalEthics/Resources.

What Comprises Relevant Ethical Requirements?

Before beginning the process of designing relevant ethical requirements policies and procedures that fit the firm's practice, it is advisable to become familiar with the many ethical rules and regulations under which the firm is required to practice. The AICPA, state boards of accountancy, state societies of CPAs, state statutes, and other regulatory agencies (such as the GAO, DOL, etc.) set forth ethical rules and regulations for their members or for CPAs who practice before them. As a result, *all* CPAs (not just members of the AICPA) are subject to such ethical requirements. After the firm initially establishes policies and procedures for relevant ethical requirements, it is important for the firm to maintain its familiarity with the ethical requirements under which it is required to operate. Such a familiarity is necessary not only to comply with QC 10, but also to monitor adherence to the firm's policies and procedures, to keep the policies and procedures current, and to ensure that quality control policies and procedures are consistent with the needs of the firm.

The Professional Ethics Executive Committee (PEEC) is a senior technical committee of the AICPA charged with the responsibility of interpreting and enforcing the Code. The Code consists of Principles and Rules, as well as Interpretations and other guidance. The Principles provide the framework on which the Rules are built. The Rules govern the performance of professional services. The Interpretations and other guidance provide guidelines regarding the scope of the Rules and how to apply them, but are not intended to limit their scope or application. Exhibit 1-5 details the Principles and Rules of the Code for members in public practice.

Exhibit 1-5

Principles and Rules in the AICPA *Code of Professional Conduct*

Description	Location
Responsibilities Principle	ET 0.300.020
The Public Interest Principle	ET 0.300.030
Integrity Principle	ET 0.300.040
Objectivity and Independence Principle	ET 0.300.050
Due Care Principle	ET 0.300.060
Scope and Nature of Services Principle	ET 0.300.070
Integrity and Objectivity Rule	ET 1.100.001
Independence Rule	ET 1.200.001
General Standards Rule	ET 1.300.001
Compliance With Standards Rule	ET 1.310.001
Accounting Principles Rule	ET 1.320.001
Acts Discreditable Rule	ET 1.400.001
Contingent Fees Rule	ET 1.510.001
Commissions and Referral Fees Rule	ET 1.520.001
Advertising and Other Forms of Solicitation Rule	ET 1.600.001

Description	Location
Confidential Client Information Rule	ET 1.700.001
Form of Organization and Name Rule	ET 1.800.001

The following paragraphs briefly discuss each Principle and Rule of the Code included in Exhibit 1-5. As previously mentioned, the Rules listed in Exhibit 1-5 relate to members in public practice only. Discussion of the Rules related to members in business and other members is outside the scope of this course.

QC 10.A7 and AU-C 220.A4 repeat the Principles of the Code and explain that they establish the fundamental principles of professional ethics. The Principles are explained by the Code as follows—

- *Responsibilities Principle.* Members should carry out their responsibilities by exercising sensitive professional and moral judgments in all their activities.
- *The Public Interest Principle.* Members should act in a manner that serves the public interest, honors the public trust, and demonstrates commitment to professionalism.
- *Integrity Principle.* To maintain and broaden the public's confidence, members should perform their professional responsibilities with the highest sense of integrity.
- *Objectivity and Independence Principle.* A member should maintain objectivity and be free of conflicts of interest when discharging professional responsibilities. A member in public practice should be independent in both fact and appearance when providing all attestation services that require independence.
- *Due Care Principle.* A member should comply with the profession's technical and ethical standards, continually strive to improve competence to enhance the quality of services provided, and discharge all professional responsibilities to the best of their ability.
- *Scope and Nature of Services Principle.* A member in public practice should follow the Principles of the Code in determining the scope and nature of services to be provided.

With the exception of independence, the Principles apply to all AICPA members and in all professional engagements. That is, regardless of whether a member is performing an attest service, consulting service, or valuation service, a member is subject to the requirements of the Principles of the Code. The principle of independence applies only to members in public practice when they provide attest services or nonattest services to attest clients. QC 10.A9 explains that the Principles are reinforced by—

- Leadership of the firm.
- Education and training.
- Monitoring.
- Establishing a process for dealing with noncompliance.

Each of the Principles is discussed in more detail in the following paragraphs.

Responsibilities Principle. As members of the AICPA, practitioners are expected to be aware of their responsibility to the users of their professional services. AICPA members also have a continuing responsibility to cooperate with other members and practitioners to improve the profession of accounting, maintain the public's confidence in the profession, and carry out the profession's responsibilities of self-governance.

The Public Interest Principle. The AICPA defines the accounting profession's public as consisting of clients, credit grantors, governments, employers, investors, the business and financial community, and others who rely on the objectivity and integrity of CPAs to maintain the orderly function of commerce. The public interest is the collective well-being of the community of people and institutions the profession serves. When members encounter conflicting

pressures from those groups, members should act with integrity and be guided by their responsibility to the public. The public relies on CPAs to act with integrity, objectivity, due professional care, and a genuine interest in serving the public.

Integrity Principle. *Merriam-Webster's Dictionary* defines *integrity* as “firm adherence to a code of especially moral or artistic values; incorruptibility.” That definition says a lot about integrity as a foundational value; but the Code describes integrity specifically in terms of the member’s responsibility. Integrity requires a member to be honest and candid, yet respect the constraints of client confidentiality. Practitioners can make inadvertent mistakes or have honest differences of opinion and still maintain integrity. However, practitioners cannot practice deceit or subordination of principle and keep their integrity. Integrity is measured in terms of what is right and just, and it also requires a member to observe the principles of objectivity, independence, and due care. Integrity requires a member to observe both the form and the spirit of technical and ethical standards. It is the quality against which a member must test all decisions.

Objectivity and Independence Principle. *Merriam-Webster's Dictionary* defines *objectivity* in general terms as “an expressing or dealing with facts or conditions without distortion by personal feelings, prejudices, or interpretations.” The Code discusses objectivity as a state of mind that adds value to a member’s services, but also imposes an obligation to be impartial, intellectually honest, and free of conflicts of interest. To be independent, members should avoid relationships that may appear to impair their objectivity in providing attest services.

Members in public practice maintain objectivity and independence through a continual assessment of client relationships and public responsibility. Members who provide audit and other attest services should be independent in both fact and appearance. When providing all other services, members should maintain objectivity and avoid conflicts of interest.

The authors view objectivity as being similar to integrity in that it relates to the individual’s state of mind and is not an ethical decision made before accepting or commencing an engagement. Individuals with integrity will practice with objectivity.

When Is Independence Required? Independence requirements can be found in the compilation and review, attestation, and auditing standards of the AICPA. While the authoritative literature governing these various types of engagements contains a great deal of discussion about (a) the concepts of independence and objectivity, (b) identifying independence problems, and (c) resolving nonindependence situations, the basic concept of independence is the same regardless of the level of service or the type of engagement. Accountants are independent if they are free from obligation to or interest in their clients. The basic independence requirements found in the compilation and review, attestation, and auditing standards of the AICPA are detailed in Exhibit 1-6. Independence requirements are discussed later in this lesson.

Exhibit 1-6**Independence Requirements by Type of Engagement**

Type of Engagement	Requirement if Not Independent
Historical Financial Statements:	
• Preparations	The preparation service is a <i>nonattest</i> service and, as such, does not require the accountant to be independent (AR-C 70.03).
• Compilations	The accountant may issue a standard compilation report but should include a statement about the lack of independence. The accountant has the option to disclose in the compilation report the reason(s) that independence is impaired, but if one reason is disclosed, all reasons must be disclosed (AR-C 80.22–.23).
• Reviews	The accountant must be independent and should withdraw from the engagement if their independence is impaired (AR-C 90.10).
• Audits	The auditor must be independent of the entity when performing an engagement under generally accepted auditing standards (GAAS) unless (a) GAAS provides otherwise or (b) the auditor is required by law or regulation to accept the engagement and report on the financial statements. When the auditor is not independent and neither (a) nor (b) apply, the auditor may not issue a report under GAAS (AU-C 200.15).
	When the auditor is not independent but is still required by law or regulation to report on the financial statements, the auditor should disclaim an opinion and should specifically state that they are not independent (AU-C 705.16).
	Observation: In reality, auditors rarely enter into an audit engagement where they lack independence (except when required by law or regulation to report on the financial statements) because a disclaimer of opinion is not a product that would be acceptable to the client or third parties.
Prospective Financial Information:	
• Compilations	The accountant may issue a compilation report, but should include a statement about lack of independence. The accountant has the option to disclose in the compilation report the reason(s) that independence is impaired, but if one reason is disclosed, all reasons must be disclosed (AR-C 120.06 and AR-C 120.13).
• Examinations	The practitioner is precluded from accepting the engagement and issuing a report unless required by law or regulation (AT-C 105.26).
• Agreed-upon Procedures	The practitioner is precluded from accepting the engagement and issuing a report unless required by law or regulation (AT-C 105.26).
Other Attestation Engagements:	
• Reviews	The practitioner is precluded from accepting the engagement and issuing a report unless required by law or regulation (AT-C 105.26).
• Examinations	The practitioner is precluded from accepting the engagement and issuing a report unless required by law or regulation (AT-C 105.26).
• Agreed-upon Procedures	The practitioner is precluded from accepting the engagement and issuing a report unless required by law or regulation (AT-C 105.26).

Due Care Principle. Due care requires competence and diligence, and obligates performance of professional services to the best of the AICPA member's ability. Competence begins with education and experience and is maintained by continual learning throughout a member's professional life. In all engagements and responsibilities, a member undertakes to achieve a level of competence that assures the quality of the member's services meets the high level of professionalism required by the Principles of the Code. Being competent also requires consultation when an engagement exceeds the member's or firm's own level of competence. Members are responsible for assessing whether their own education, experience, and judgment are adequate for the engagement. Due care also requires adequate planning and supervision.

Scope and Nature of Services Principle. This principle requires that AICPA members consider whether specific services to be provided are consistent with the Principles of public interest, integrity, objectivity and independence, and due care. Members should do the following:

- Practice in firms with quality control systems.
- Determine whether the nature and scope of nonaudit services provided to an audit client would create a conflict of interest in the audit.
- Assess, according to their individual judgment, whether an activity is consistent with their role as professionals.

Integrity and Objectivity Rule. The *Integrity and Objectivity Rule* requires that when performing professional services, members—

- maintain objectivity and integrity,
- have no conflicts of interest, and
- not knowingly misrepresent facts or subordinate their judgment.

The Interpretations of the *Integrity and Objectivity Rule* include the following topics (excluding discussion of the application of the *Conceptual Framework for Members in Public Practice* and *Ethical Conflicts* earlier in this section:

- *Conflicts of Interest.* A conflict of interest that presents an adverse interest or self-interest threat to compliance with the Rule may occur when performing a professional service if a member or the member's firm has a relationship or other matter that could be viewed as creating a conflict of interest. Before a client relationship, engagement, or business relationship is accepted, the member 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. Considering conflicts of interest as part of accepting and continuing an attest engagement is discussed in Lesson 2.
- *Gifts and Entertainment.* Threats to compliance with the *Integrity and Objectivity Rule* would not be at an acceptable level, nor could they be reduced to an acceptable level by the application of safeguards in either of the following circumstances:
 - The member offers or accepts from a client gifts or entertainment that violate the member's or client's policies or applicable laws, rules, and regulations and the member knows of the violation or demonstrates recklessness in not knowing.
 - The member offers or accepts from a client gifts or entertainment that is not reasonable in the circumstances.
- *Preparing and Reporting Information.* This Interpretation of the *Integrity and Objectivity Rule* discusses the following two situations that would violate the Rule:
 - Knowingly misrepresenting an entity's financial statements or records, and
 - Subordination of judgment.

- **Client Advocacy.** When a member or the member's firm is engaged to perform nonattest services (such as tax or consulting services) that involve acting as an advocate for the client or supporting a client's position on accounting or financial reporting matters, either within the firm or outside the firm with standard-setters, regulators, or others, an advocacy threat to compliance with the *Integrity and Objectivity Rule* may exist. When a professional service involving client advocacy stretches the bounds of performance standards, goes beyond sound and reasonable professional practice, or compromises credibility, the member and the firm should determine whether it is appropriate to perform the service.
- **Use of a Third-party Service Provider.** Before disclosing confidential client information to a third-party service provider, the member should inform the client, preferably in writing, that a third-party service provider may be used. If the client objects, the member should either decline the engagement or perform the services without using the third-party service provider. See additional discussion about ethics requirements when using third-party service providers in Lesson 2.

In June 2021, PEEC published a practice aid that provides guidance to members on evaluating threats to a member's integrity and objectivity. The practice aid, *Understanding circumstances that may compromise your integrity and objectivity*, is available on the AICPA's website at us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/practice-aid-integrity-objectivity.pdf.

Approved Interpretation, *Responding to Non-Compliance with Laws and Regulations*. In March of 2017, PEEC issued a proposed interpretation, *Responding to Non-Compliance with Laws and Regulations* (commonly referred to as *Responding to NOCLAR*) (ET 1.170.010), under the *Integrity and Objectivity Rule* (ET 1.100.001). There has been much discussion and debate on NOCLAR and many stakeholders have weighed in on the proposed guidance since it was first exposed. As a result, PEEC re-exposed the interpretation in February 2021 as two interpretations: one for members in public practice (ET 1.170.010) and one for members in business (ET 2.170.010). In its February 2022 board meeting, PEEC made several additional changes and then approved the revised interpretations for issuance. The two interpretations provide guidance for members when they encounter or suspect non-compliance with laws or regulations. The effective date of the interpretations will be one year after the announcement is published in the *Journal of Accountancy*. Early implementation is allowed. The official release will be available on the AICPA's website at us.aicpa.org/interestareas/professionalethics/community/peec-project-activity.html.

In conjunction with PEEC's project, in 2019, the Auditing Standards Board (ASB) began working on a related NOCLAR project specific to audit engagements. In February 2021, the ASB issued a proposed SAS, *Inquiries of the Predecessor Auditor Regarding Fraud and Noncompliance With Laws and Regulations*, which would amend AU-C 210, *Terms of Engagement*.

Independence Rule. The *Independence Rule* states that, when performing professional services, members in public practice shall be independent as required by applicable professional standards. See discussion of the *Independence Rule* and its Interpretations later in this lesson.

General Standards Rule. The *General Standards Rule* requires that members comply with the following standards and related interpretations established by bodies designated by the AICPA Council:

- **Professional Competence.** Only professional services that are expected to be completed with professional competence are to be undertaken.
- **Due Professional Care.** Due professional care is to be exercised when performing professional services.
- **Planning and Supervision.** Professional services are to be adequately planned and supervised.
- **Sufficient Relevant Data.** Sufficient relevant data is to be obtained to provide a reasonable basis for conclusions or recommendations.

The Interpretations of the *General Standards Rule* include the following topics (excluding discussion of the application of the *Conceptual Framework for Members in Public Practice* and *Ethical Conflicts* Interpretation from earlier in this section):

- **Competence.** A member's agreement to perform professional services implies that the member has the necessary competence to complete those services according to professional standards and to apply knowledge and skill with reasonable care and diligence. A member who does not have the required knowledge to complete the service prior to undertaking it may obtain the knowledge through additional research or consultation during the performance of the services.
- **Supervision of a Specialist on Consulting Engagements.** A member who employs a specialist to perform consulting services for the member's clients must be qualified to supervise and evaluate the specialist's work.
- **Submission of Financial Statements.** A member who prepares or submits financial statements as a stockholder, partner, director, officer, or employee of an entity using the firm's letterhead or similar identification should comply with the *Compliance With Standards Rule* discussed below.
- **Use of a Third-party Service Provider.** A member who uses a third-party service provider to assist in providing professional services (such as bookkeeping, tax preparation, or consulting or attest services, including related clerical or data entry functions) is required to comply with the *General Standards Rule* and the *Compliance With Standards Rule*.

Compliance With Standards Rule. The *Compliance With Standards Rule* requires that members comply with standards established by bodies designated by the AICPA Council when performing audits, reviews, compilations, management consulting, tax, or other professional services. The single Interpretation of the *Compliance With Standards Rule* is the application of the *Conceptual Framework for Members in Public Practice* and *Ethical Conflicts*, discussed earlier in this section.

Accounting Principles Rule. The *Accounting Principles Rule* indicates that if financial statements or other financial data contain a material departure from an accounting principle established by a body designated by the AICPA Council to do so, the member shall not—

- Express an opinion or state that the financial statements or other financial data are presented in conformity with GAAP.
- State that they are not aware of any material modifications that should be made in order for the financial statements or other financial data to be in conformity with GAAP.

The Interpretations of the *Accounting Principles Rule* include the following topics (excluding discussion of the application of the *Conceptual Framework for Members in Public Practice* and *Ethical Conflicts* Interpretation, which was previously discussed):

- **Responsibility for Affirming that Financial Statements Are in Conformity with the Applicable Financial Reporting Framework.** A member must not affirmatively state that financial statements or other financial data are presented in conformity with GAAP if the statements or data contain any departure from an accounting principle promulgated by a body designated by the AICPA Council to establish such principles. Members who affirm that financial statements or other financial data are presented in accordance with applicable GAAP should comply with the *Accounting Principles Rule*.
- **Status of FASB, GASB, FASAB, and IASB Interpretations.** In applying the *Accounting Principles Rule* and considering whether there is a departure from an accounting principle established in the FASB *Accounting Standards Codification*[™] (ASC), *Statements of Governmental Accounting Standards*, *Statements of Federal Accounting Standards*, or *International Financial Reporting Standards*, the AICPA Ethics Division considers the codification or statements and any interpretations issued by the FASB, GASB, FASAB, or IASB.
- **Departures from Generally Accepted Accounting Principles.** In the unusual circumstances when the literal application of GAAP would cause financial statements to be misleading, the proper accounting treatment

to apply is the one that will not cause the financial statements to be misleading. The determination of *unusual circumstances* is a matter of professional judgment involving the ability to support the position that adhering to GAAP would be regarded by reasonable persons as producing misleading financial statements.

- *Financial Statements Prepared Pursuant to Financial Reporting Frameworks Other than GAAP.* The *Accounting Principles Rule* does not preclude members from preparing or reporting on financial statements that use financial reporting frameworks other than GAAP. However, in such circumstances, the financial statements or reports should not purport that the financial statements are in accordance with GAAP and should make clear the financial reporting framework that was used.

Acts Discreditable Rule. The *Acts Discreditable Rule* states that members shall not commit acts that are discreditable to the profession. The Interpretations of the *Acts Discreditable Rule* include the following topics (excluding discussion of the application of the *Conceptual Framework for Members in Public Practice* and *Ethical Conflicts* Interpretation, which was discussed earlier in this section):

- *Discrimination and Harassment in Employment Practices.* A member who is finally determined by a court or an administrative agency of competent jurisdiction to have violated any federal, state, or municipal antidiscrimination laws, including those related to sexual and other forms of harassment, is presumed to have committed an act discreditable to the profession.
- *Solicitation or Disclosure of CPA Examination Questions and Answers.* A member who solicits or knowingly discloses CPA Examination questions and/or answers without the AICPA's written authorization is considered to have committed an act discreditable to the profession.
- *Failure to File a Tax Return or Pay a Tax Liability.* A member who fails to (a) file, on a timely basis, their personal tax returns or those of the member's firm that the member has the authority to file, or (b) remit, on a timely basis, all payroll and other taxes collected on behalf of others may be considered to have committed an act discreditable to the profession.
- *Negligence in the Preparation of Financial Statements or Records.* The following acts resulting from a member's negligence are acts discreditable to the profession:
 - Making, or directing or permitting another person to make, materially false and misleading entries in the financial statements or records of an entity.
 - Failing to correct materially false and misleading financial statements of an entity when the member has the authority to record an entry.
 - Signing, or directing or permitting another person to sign, a document that contains materially false and misleading information.
- *Governmental Bodies, Commissions, or Other Regulatory Agencies.* In preparing financial statements or related information or performing attest or similar services for entities subject to oversight by governmental agencies for the purpose of reporting to the agency, the member should follow the organization's requirements, such as those established in audit standards, guides, rules, or regulations. A material departure from such requirements is an act discreditable to the profession, unless the financial statements or report (as applicable) discloses the failure to follow the requirements and the reasons.
- *Governmental Audits.* A member who accepts an engagement to audit government grants, governmental units, or other recipients of government monies when such audits are to be performed in compliance with government audit standards, guides, procedures, statutes, rules, and regulations in addition to GAAS, is obligated to follow such requirements. Failure to follow such standards would be an act discreditable to the profession, unless the report discloses the failure to follow such requirements and the reasons.
- *Indemnification and Limitation of Liability Provisions.* It is an act discreditable to the profession to enter into, or direct or knowingly permit another individual to enter into, a contract to perform audit or other attest services that includes an indemnification or limitation of liability provision when the services are subject to the requirements of a regulator (e.g., governmental body, commission, or other regulatory agency) that

prohibits such provisions or disqualifies a member from providing such services if the provisions are included.

- *Confidential Information Obtained from Employment or Volunteer Activities.* A member should maintain confidentiality of their employer's or firm's confidential information and should not use or disclose such information obtained as a result of an employment relationship, such as through discussions with the employer's vendors, customers, or lenders. A member would be considered to have committed an act discreditable to the profession if the member discloses or uses any confidential employer information acquired as a result of employment or volunteer relationships without the proper authority or specific consent of the employer or organization for whom the member may work in a volunteer capacity, unless there is a legal or professional responsibility to use or disclose such information.
- *False, Misleading, or Deceptive Acts in Promoting or Marketing Professional Services.* A member who, in promoting or marketing their abilities to provide professional services, makes false, misleading, or deceptive claims about their experience or qualifications will be considered to have committed an act discreditable to the profession.
- *Use of the CPA Credential.* A member should refer to applicable state accountancy laws and board of accountancy rules and regulations for guidance regarding use of the CPA credential. A member who does not follow the accountancy laws, rules, and regulations regarding use of the CPA credential in all jurisdictions in which they practice would be considered to have used the CPA credential in a manner that is false, misleading, or deceptive, and in violation of the *Acts Discreditable Rule*.
- *Records Requests.* A member must comply with the rules and regulations of authoritative regulatory bodies, such as state board(s) of accountancy, when the member performs services for a client and is subject to the rules and regulations of such regulatory body. Failure to comply with more restrictive provisions contained in the applicable regulatory body's rules and regulations concerning the return of certain records would constitute a violation of this Interpretation. Failure to comply with any other requirements in this Interpretation also would be an act discreditable to the profession. Client-provided records that are in the member's custody or control should be returned upon the client's request. The member should comply with the client's request to return or provide records as soon as practicable, but no later than 45 days after the request is made unless there are extenuating circumstances. The information should be provided in any usable and accessible format. The member is not required to convert records that are not in electronic format to electronic format. The member may charge a reasonable fee for the time and expense of retrieving and copying records and may require that the fee be paid before providing the records to the client.
- *Transfer of Files and Return of Client Records in Sale, Transfer, Discontinuance or Acquisition of a Practice.* A member or the member's firm that sells or transfers all or part of its practice and will no longer retain any ownership in the practice should (1) submit a written request to each client subject to the sale or transfer requesting the client's consent to transfer its files to the successor firm (and not transfer any client files until consent is obtained or a waiting period has lapsed as described in the interpretation); and (2) for files not subject to the sale or transfer, return any client records that the member is required to provide to the client, as set forth in the *Records Requests* Interpretation. Additionally, a member who discontinues their practice, but does not sell or transfer the practice, should follow similar procedures as described in (1) and (2) above, except with regard to notifying clients of the discontinuation of the practice. A member who acquires all or part of a practice should be satisfied that all of the clients of the predecessor firm have consented to the retention of client records and the continuation of services, as required by the Interpretation.
- *Removing Client Files or Proprietary Information from a Firm.* A nonowner member of the firm whose employment is terminated would be in violation of the *Acts Discreditable Rule* if they take or retain (a) original information or copies (in any format) from the firm's client files or (b) proprietary information without the firm's permission, unless a contractual arrangement between the member and the firm allows such action.
- *Use of Confidential Information from Nonclient Sources.* It would be an act discreditable to the professional to disclose confidential information obtained from a prospective client or nonclient without consent.

Contingent Fees Rule. The *Contingent Fees Rule* states that members in public practice shall not—

- Perform professional services for a contingent fee or receive a contingent fee from a client for whom the member or the firm performs (a) an audit or review of a financial statement; (b) a compilation of a financial statement when the member expects that a third party will use the financial statement and the compilation report does not disclose the member's lack of independence; or (c) an examination of prospective financial information. This prohibition applies during the period in which the member or firm is engaged to perform the services as well as the period covered by any related historical financial statements.
- Prepare a tax return or a claim for a tax refund for a contingent fee for any client.

The Interpretations of the *Contingent Fees Rule* include the following topics (excluding the previous discussion of the application of the *Conceptual Framework for Members in Public Practice* and *Ethical Conflicts* Interpretation):

- *Tax Matters.* A contingent fee is not permitted for preparing a client's amended federal or state income tax return that claims a refund because the original return inadvertently omitted a valid deduction. The Interpretation also indicates the specific circumstances under which contingent fees are allowed for tax services.
- *Receipt of a Contingent Fee.* A contingent fee is considered to be received at the time when the related services have been completed and the fee is determined.
- *Services Performed by a Member's Spouse for a Contingent Fee.* A member's spouse may receive a contingent fee from the member's attest client as long as the spouse's activities are separate from the member's practice and do not significantly involve the member. The member should, however, consider the *Conflicts of Interest* Interpretation of the *Integrity and Objectivity Rule* to determine the appropriate course of action.
- *Contingent Fee Arrangements with an Investment Advisory Services Nonattest Client That Is Related to a Client.* A member or member's firm may provide investment advisory services for a contingent fee to the owners, officers, or employees of an attest client or to a nonattest client employee benefit plan that is sponsored by an attest client. The member should, however, consider the *Conflicts of Interest* Interpretation of the *Integrity and Objectivity Rule* to determine the appropriate course of action.
- *Investment Advisory Services.* A member or member's firm may provide investment advisory services for a fee based on a percentage of an attest client's investment portfolio, provided that the safeguards listed in the Interpretation are met.

Commissions and Referral Fees Rule. The *Commissions and Referral Fees Rule* explains when commissions and referral fees are prohibited for members in public practice. The Rule also explains the requirements for members when those prohibitions do not apply and commissions and referral fees are acceptable, and when members are required to disclose the commission (or expected commission) in writing. The Interpretations of the *Commissions and Referral Fees Rule* include the following topics (excluding the previous discussion of the application of the *Conceptual Framework for Members in Public Practice* and *Ethical Conflicts* Interpretation):

- *Receipt of Commission.* A commission is considered to be received when the member has completed the related services and the fee is determined.
- *Services Performed by a Member's Spouse for a Commission.* A member's spouse may receive a commission from the member's attest client as long as the spouse's activities are separate from the member's practice and do not significantly involve the member.
- *Referral of Products of Others.* This Interpretation explains that the requirements of the *Commissions and Referral Fees Rule* also apply when a commission or referral fee would be paid through a distributor or agent.
- *Commission Arrangements with an Investment Advisory Services Nonattest Client That Is Related to a Client.* A member or member's firm may receive a commission for referring a nonclient's or nonattest client's products or services to the owners, officers, or employees of an attest client or to a nonattest client

employee benefit plan sponsored by an attest client. The member should, however, disclose the commission arrangement to the client's owners, officers, or employees or the employee benefit plan, or be in violation of the *Commissions and Referral Fees Rule*.

- *Sale of Products to Clients.* Any profit realized when a member purchases a product, takes title to it, assumes all the associated risks of ownership, and resells it to a client would not constitute a commission.
- *Billing for a Subcontractor's Services.* A member who subcontracts the services of another person or entity when providing professional services may bill the client a higher service fee than the subcontractor charged to the member, and the fee would not constitute a commission.

Advertising and Other Forms of Solicitation Rule. The *Advertising and Other Forms of Solicitation Rule* states that, when soliciting clients, members in public practice are not to (a) use advertising or other forms of solicitation in a false, misleading, or deceptive manner, or (b) use conduct that is coercive, over-reaching, or harassing. The Interpretations of the *Advertising and Other Forms of Solicitation Rule* include the following topics (excluding discussion of the application of the *Conceptual Framework for Members in Public Practice* and *Ethical Conflicts Interpretation*, which was provided earlier in this section):

- *False, Misleading, or Deceptive Acts in Advertising or Solicitations.* A member's promotional efforts are considered to be false, misleading, or deceptive and a violation of the *Advertising and Other Forms of Solicitation Rule* if they—
 - Create false or unjustified expectations of favorable results.
 - Imply the ability to influence a court, tribunal, regulatory agency, or similar body or official.
 - Represent that the member will perform specific professional services for a stated or estimated fee or fee range if it is likely that the fees will substantially increase and the member does not inform the prospective client of that likelihood.
 - Make any other representations that a reasonable person is likely to misunderstand or be deceived by.
- *Use of AICPA-awarded Designation.* A member who holds an AICPA-awarded designation, such as Personal Financial Specialist, may use the designation after their name. However, an AICPA-awarded designation may be used on a firm's letterhead or in its marketing materials only if all of the firm's partners hold the designation.
- *Use of the CPA Credential.* A member should refer to applicable state accountancy laws and board of accountancy rules and regulations for guidance on the use of the CPA credential. A member who does not follow such laws, rules, and regulations in all jurisdictions in which the CPA practices will have used the CPA credential in a manner that is false, misleading, or deceptive, and in violation of the *Advertising and Other Forms of Solicitation Rule*.

Confidential Client Information Rule. The *Confidential Client Information Rule* states that members in public practice shall not disclose confidential client information unless the client has specifically consented to the disclosure. The Interpretations of the *Confidential Client Information Rule* include the following topics (excluding the previous discussion of the application of the *Conceptual Framework for Members in Public Practice* and *Ethical Conflicts Interpretation*):

- *Client Competitors.* A member who provides professional services to clients that are competitors should emphasize to all relevant parties, including employees of the firm and impacted clients, that the *Confidential Client Information Rule* prohibits members from revealing to others any confidential client information obtained in their professional capacity.
- *Disclosing Information from Previous Engagements.* When evaluating whether to accept a new engagement, a member should consider whether knowledge and experience the member or firm will share when providing professional services to the client would be confidential client information. If it would be confidential client information and the prospective client would be able to identify the client or clients that

are the source of the information, the engagement should not be accepted unless the member obtains the original client's specific consent to disclose the information.

- *Disclosing Information to Clients.* Both spouses become the client when a member is retained by one of the spouses to prepare a joint tax return, even if the member deals exclusively with one spouse. The member may provide joint tax information to both spouses, even if the couple is in divorce proceedings and one spouse directs the member to withhold joint tax information from the other spouse. The member should consider reviewing the legal implications of such disclosure with legal counsel as well as the member's responsibilities under any tax performance standards. When a person or entity engages a member to perform services (engaging entity) for another person or entity (beneficiary), the engaging entity and beneficiary are considered two separate clients. The member may not share confidential client information of either client with the other without the consent of the client whose confidential information is to be shared. For example, if a member provides professional services to a company's executives at the request of the company, disclosure of confidential client information to the company without the executives' consent would be a violation of the *Confidential Client Information Rule*, even if the company is not otherwise a client.
- *Disclosing Information to a Third-party Service Provider.* Before disclosing confidential client information to a third-party service provider, the member should (a) enter into a contractual agreement with the third-party service provider to maintain the confidentiality of the information and provide reasonable assurance that the third-party service provider has appropriate procedures in place to prevent the unauthorized release of confidential information to others, and (b) obtain specific consent from the client before disclosing confidential client information to the third-party service provider.
- *Disclosing Client Information in Connection with a Review of the Member's Practice.* A member must take appropriate precautions (for example, through a written confidentiality agreement) to help ensure that a prospective purchaser of the member's professional practice does not disclose any confidential client information obtained in performing a review in conjunction with a purchase, sale, or merger of all or part of the practice. A member who performs such review should not disclose, or use to their advantage, any information obtained during the review. Members who obtain client files as the result of acquiring all or part of another practice should not disclose any confidential client information contained in such files. See the earlier discussion of the *Transfer of Files and Return of Client Records in Sale, Transfer, Discontinuance or Acquisition of a Practice* Interpretation.
- *Disclosure of Client Information to Third Parties.* A member may not disclose confidential client information to third parties or use such information for their own purposes unless the member has obtained the client's specific consent, preferably in writing, as to the nature of the information that may be disclosed, the type of third party to whom it may be disclosed, and its intended use.
- *Disclosing Client Information During Litigation.* A member is not prohibited from disclosing information necessary to initiate, pursue, or defend the member in an actual or threatened lawsuit or alternative dispute resolution proceeding.
- *Disclosing Client Information in Director Positions.* A member's fiduciary responsibilities to an entity (such as a bank or insurance company) for which the member serves as a director may create threats to the member's compliance with the *Integrity and Objectivity Rule* and the *Confidential Client Information Rule*. The member should evaluate the significance of any such threats and apply safeguards, when necessary, to eliminate the threats or reduce them to an acceptable level.
- *Disclosing Client Names.* Clients' names may be disclosed if doing so does not constitute releasing confidential client information.
- *Disclosing Confidential Client Information as a Result of a Subpoena or Summons.* The member may disclose confidential client information in response to a validly issued and enforceable subpoena or summons. The member is not required to notify the client that its records have been subpoenaed or that a summons related to the client's records was issued. The member may wish to consult with legal counsel to determine the validity and enforceability of the subpoena or summons and the specific client information required to be provided.

- *Disclosing Client Information in Connection With a Quality Review.* A review of a member's professional practice includes a quality review of the member's tax practice. When a third party is used to perform such reviews, threats to compliance with the *Confidential Client Information Rule* may exist. The interpretation requires members performing quality reviews not to use to their advantage or disclose any information obtained in the course of the review. Additionally, members obtaining such reviews should, at a minimum, ensure that the disclosure requirements of Treasury Regulation 301.7216-2(p) are met and apply additional safeguards to reduce any threats identified to an acceptable level.

Form of Organization and Name Rule. The *Form of Organization and Name Rule* explains that:

- Members may practice public accounting only (a) in a form of organization permitted by law or regulation and with characteristics that conform to AICPA Council resolutions and (b) under a firm name that is not misleading.
- A firm may not be identified as "Members of the American Institute of Certified Public Accountants" unless all of its CPA owners are AICPA members.
- The name of a successor firm may include names of former owners.

The Interpretations of the *Form of Organization and Name Rule* include the following topics (excluding discussion of the application of the *Conceptual Framework for Members in Public Practice* and *Ethical Conflicts* Interpretation earlier in this section):

- *Ownership of a Separate Business.* A member may own an interest in a separate business that performs for clients accounting, tax, personal financial planning, or litigation support services or other services for which standards have been established by bodies designated by the AICPA Council. The Interpretation includes requirements that apply when the member controls the separate business.
- *Partner Designation.* Members of a firm who are not legally partners should not use the designation of *partner* and should not hold themselves out in any manner that might lead clients or the public to believe that they are partners.
- *A Member's Responsibility for Nonmember Practitioners.* The Interpretation explains a member's responsibility when the member is employed by a firm that also employs nonmember practitioners, or the member becomes owner in a firm that employs nonmember practitioners.
- *Attest Engagement Performed with a Former Partner.* Two former partners may continue to jointly perform an attest engagement, even if one of them is not a CPA, except when applicable laws, rules, or regulations conclude otherwise.
- *Alternative Practice Structures.* An AICPA Council resolution related to the *Form of Organization and Name Rule* requires that CPAs own a majority of the financial interests of a firm engaged in attest services and remain responsible, financially and otherwise, for the attest work performed. If a CPA firm in an Alternative Practice Structure (APS) pays all or substantially all of its revenues to another entity that is part of the same APS in return for services and leased office space, equipment, and employees, the following requirements of the Code and Bylaws must also be met:
 - Compliance with all aspects of applicable law or regulation.
 - Enrollment in a practice monitoring program approved by the AICPA.
 - Compliance with the *Independence Rule*.
 - Compliance with applicable standards established by bodies designated by the AICPA Council to issue standards.
 - Compliance with all other provisions of the Code.

- *Use of a Retired Partner's Name.* Former partners' names may be used in a firm's name. For example, if two firms merge, the new firm may include the names of retired or other partners from either or both of the merged firms in its own name.
- *A Practice with Non-CPA Partners.* Except when applicable laws, rules, or regulations conclude otherwise, a CPA member who is in a partnership with non-CPAs may (a) sign reports in the firm's name and (b) add the designation, Certified Public Accountant, to their signature as long as the partnership itself is not being held out as consisting entirely of CPAs.
- *Misleading Firm Names.* A member is prohibited from practicing public accounting using a misleading firm name. In addition, the member should consider the rules and regulations of the state board(s) of accountancy in which the member practices concerning misleading firm names that may be more restrictive than this Interpretation.
- *Use of a Common Brand Name in Firm Name.* The sharing of a common brand name or common initials of a network as part of a member's firm name would not be considered misleading, provided the firm is a network firm. Furthermore, sharing a common brand name or common initials of a network as the entire name of a member's firm would not be misleading if the firm is a network firm and shares one or more of the following characteristics with other firms in the network:
 - Common control among the firms through ownership, management, or other means.
 - Profits or costs other than costs of operating the network; costs of developing audit methodologies, manuals, and training courses; and immaterial costs.
 - Common business strategy with ongoing collaboration among the firms such that the firms are responsible for implementing the network's strategy and are held accountable for performing according to that strategy.
 - Significant part of professional resources.
 - Common quality control policies and procedures that the firms are required to implement and that are monitored by the network.

GAO Ethical Principles

The GAO's *Government Auditing Standards* (commonly known as the Yellow Book) discuss the fundamental ethical principles that are the foundation for all work performed under those standards. The Yellow Book provides the following ethical principles to guide auditors in conducting audits in accordance with the Yellow Book:

- The public interest.
- Integrity.
- Objectivity.
- Proper use of government information, resources, and positions.
- Professional behavior.

The Yellow Book ethical principles and implementation guidance 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*.

SELF-STUDY QUIZ

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

1. What is the overarching requirement about ethical requirements made by QC 10.21?
 - a. That audit team members remain alert for evidence of noncompliance with relevant ethical requirements by other members of the engagement team.
 - b. That practitioners should accept attestation engagements only when certain criteria are met, including criteria related to ethical requirements.
 - c. That firms establish policies and procedures designed to provide reasonable assurance of compliance with relevant ethical requirements.
 - d. That engagement partners are alert throughout the engagement for evidence of noncompliance by anyone on the engagement team.
2. Monica serves as a forensic accountant for an audit client that is undergoing a lawsuit. This could be an example of which of the following?
 - a. Advocacy threat.
 - b. Familiarity threat.
 - c. Self-interest threat.
 - d. Undue influence threat.
3. Which of the following is a safeguard against the threats listed in ET 1.000.010.10–16 that can be implemented by the firm?
 - a. Having an external review of the firm's quality control system.
 - b. Designating a member of management to oversee the firm's quality control system.
 - c. Having client personnel with suitable skill, knowledge, or experience make managerial decisions.
 - d. Requiring members of the firm stress the importance of complying with ethical requirements and acting in the public interest.
4. What is the *due care principle*?
 - a. Members should carry out their responsibilities by exercising sensitive professional and moral judgments in all their activities.
 - b. To maintain and broaden the public's confidence, members should perform their professional responsibilities with the highest sense of integrity.
 - c. A member should comply with the profession's technical and ethical standards, continually strive to improve competence to enhance the quality of services provided, and discharge all professional responsibilities to the best of their ability.
 - d. A member in public practice should follow the Principles of the Code in determining the scope and nature of services to be provided.

5. Which of the following topics is part of the *General Standards Rule*?
- a. Professional judgment.
 - b. Accounting principles.
 - c. Independence.
 - d. Sufficient relevant data.
6. Which of the following AICPA members is correctly following guidance from the *Confidential Client Information Rule*?
- a. Alice refuses to accept an engagement because the knowledge and experience she would share is confidential to an existing client.
 - b. Frank discusses information learned from one client with another client in the same industry.
 - c. Phoebe treats spouses as one client when it comes to sharing information but treats an engaging entity as a separate client from a related beneficiary.
 - d. Mike discloses confidential client information to his third-party service provider.
7. Which of the following is required by the Interpretations of the *Form of Organization and Name Rule*?
- a. All members of a firm must call themselves partners.
 - b. Former partners must assign the CPA partner any joint attest engagements.
 - c. Retired partners' names must be removed from the firm's name.
 - d. CPAs must own the majority of the financial interests in a firm performing attest services.

SELF STUDY ANSWERS

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

1. What is the overarching requirement about ethical requirements made by QC 10.21? **(Page 136)**
 - a. That audit team members remain alert for evidence of noncompliance with relevant ethical requirements by other members of the engagement team. [This answer is incorrect. AU-C 220.11–.12 (not QC 10.21) requires all members of the audit engagement team to remain alert throughout the engagement for any evidence of noncompliance with relevant ethical requirements by members of the engagement team.]
 - b. That practitioners should accept attestation engagements only when certain criteria are met, including criteria related to ethical requirements. [This answer is incorrect. AT-C 105.29 (not QC 10.21) indicates that the practitioner should accept an attestation engagement only when certain criteria are met, including having no reason to believe that relevant ethical requirements, including independence, will not be satisfied.]
 - c. **That firms establish policies and procedures designed to provide reasonable assurance of compliance with relevant ethical requirements. [This answer is correct. QC 10.21 stipulates an overarching requirement for firms to establish policies and procedures designed to provide reasonable assurance that the firm and its personnel comply with relevant ethical requirements.]**
 - d. That engagement partners are alert throughout the engagement for evidence of noncompliance by anyone on the engagement team. [This answer is incorrect. AR-C 60.23 (not QC 10.21) requires the engagement partner to be alert throughout the engagement for evidence of noncompliance by anyone on the engagement team.]
2. Monica serves as a forensic accountant for an audit client that is undergoing a lawsuit. This could be an example of which of the following? **(Page 139)**
 - a. **Advocacy threat. [This answer is correct. According to ET 1.000.010.10–.16, existence of the advocacy threat depends on whether a member's objectivity or independence is compromised due to promoting a client's interests or position. One example of a possible advocacy threat is when the member provides forensic accounting services to a client in litigation or a third-party dispute. Therefore, depending on the circumstances, Monica could have an advocacy threat in relation to her audit client.]**
 - b. Familiarity threat. [This answer is incorrect. Based on the guidance in ET 1.000.010.10–.16, the existence of a familiarity threat depends on whether a member will become too sympathetic to a client's interests or too accepting of the client's work or product due to having a long or close relationship with the client. There is a different threat that better applies to Monica's situation.]
 - c. Self-interest threat. [This answer is incorrect. Per ET 1.000.010.10–.16, a self-interest threat depends on whether a member could benefit, financially or otherwise, from an interest in or relationship with a client or individuals associated with the client. A different threat is more apt to apply in Monica's situation, as described above.]
 - d. Undue influence threat. [This answer is incorrect. As discussed in ET 1.000.010.10–.16, the undue influence threat exists if a member will subordinate their judgment to that of someone associated with a client or any relevant third party due to that person's reputation, expertise, aggressive or dominant personality, or attempts to coerce or exercise excessive influence over the member. Based on the information provided above, that is not the case for Monica. Therefore, a different threat is more likely to apply.]

3. Which of the following is a safeguard against the threats listed in ET 1.000.010.10–.16 that can be implemented by the firm? **(Page 139)**
- a. Having an external review of the firm's quality control system. [This answer is incorrect. According to ET 1.00.010.21–.23, this is an example of a safeguard created by the profession, legislation, or regulation, not a safeguard implemented by the firm.]
 - b. **Designating a member of management to oversee the firm's quality control system. [This answer is correct. ET 1.00.010.21–.23 provides broad categories of safeguards and related examples. Safeguards implemented by the firm include policies and procedures for implementing professional and regulatory requirements. One example of this type of safeguard is when a member of senior management is designated to oversee the firm's quality control system.]**
 - c. Having client personnel with suitable skill, knowledge, or experience make managerial decisions. [This answer is incorrect. According to ET 1.00.010.21–.23, having client personnel with suitable skill, knowledge, or experience make managerial decisions with respect to professional services and consulting third party resources when necessary is a safeguard implemented by the client, not the firm.]
 - d. Requiring members of the firm stress the importance of complying with ethical requirements and acting in the public interest. [This answer is incorrect. One of the safeguards that can be implemented by the firm, as discussed in ET 1.00.010.21–.23, is for firm leadership (not employees/firm members) to stress the importance of complying with the Rules and the expectation that engagement teams will act in the public interest.]
4. What is the *due care principle*? **(Page 142)**
- a. Members should carry out their responsibilities by exercising sensitive professional and moral judgments in all their activities. [This answer is incorrect. According to the Principles of the *Code of Professional Conduct* (the Code) found in QC 10.A7 and AU-C 220.A4, this is the *Responsibilities Principle*.]
 - b. To maintain and broaden the public's confidence, members should perform their professional responsibilities with the highest sense of integrity. [This answer is incorrect. As explained in QC 10.A7 and AU-C 220.A4, this Principle of the Code is known as the *Integrity Principle*.]
 - c. **A member should comply with the profession's technical and ethical standards, continually strive to improve competence to enhance the quality of services provided, and discharge all professional responsibilities to the best of their ability. [This answer is correct. QC 10.A7 and AU-C 220.A4 repeat the Principles of the Code and explain that they establish the fundamental principles of professional ethics. The Principle described in this answer choice is known as the *due care principle*.]**
 - d. A member in public practice should follow the Principles of the Code in determining the scope and nature of services to be provided. [This answer is incorrect. This is the *Scope and Nature of Services Principle* as that Principle of the Code is outlined in QC 10.A7 and AU-C 220.A4.]
5. Which of the following topics is part of the *General Standards Rule*? **(Page 146)**
- a. Professional judgment. [This answer is incorrect. While professional judgment is important, the *General Standards Rule* covers professional competence. It does not cover professional judgment. According to the rule, only professional services that are expected to be completed with professional competence are to be undertaken.]
 - b. Accounting principles. [This answer is incorrect. The *Accounting Principles Rule* indicates that if financial statements or other financial data contain a material departure from an accounting principle established by a body designated by the AICPA Council to do so, the member must respond as

designated by that rule. However, the *Accounting Principles Rule* is different from the *General Standards Rule*.]

- c. Independence. [This answer is incorrect. The *Independence Rule* states that, when performing professional services, members in public practice shall be independent as required by applicable professional standards. However, the *Independence Rule* is separate from the *General Standards Rule*, so they cover different topics.]
 - d. **Sufficient relevant data.** [This answer is correct. The *General Standards Rule* requires that members comply with the following standards and related interpretations established by bodies designated by the AICPA Council: (1) professional competence, (2) due professional care, (3) planning and supervision, and (4) sufficient relevant data. In regard to item (4) specifically, the *General Standards Rule* requires that sufficient relevant data be obtained to provide a reasonable basis for conclusions or recommendations.]
6. Which of the following AICPA members is correctly following guidance from the *Confidential Client Information Rule*? (Page 151)
- a. Alice refuses to accept an engagement because the knowledge and experience she would share is confidential to an existing client. [This answer is incorrect. Under the *Confidential Client Information Rule*, when evaluating whether to accept a new engagement, a member should consider whether knowledge and experience the member or firm will share when providing professional services to the client would be confidential client information. If it would be confidential client information and the prospective client would be able to identify the client or clients that are the source of the information, the engagement should not be accepted *unless* the member obtains the original client's specific consent to disclose the information. Therefore, while it is still possible Alice will need to decline this engagement, there are still actions she can take to attempt to mitigate the situation so she can accept the engagement. Therefore, there is a better answer to this question.]
 - b. Frank discusses information learned from one client with another client in the same industry. [This answer is incorrect. According to the *Confidential Client Information Rule*, a member who provides professional services to clients that are competitors should emphasize to all relevant parties, including employees of the firm and impacted clients, that the *Confidential Client Information Rule* prohibits members from revealing to others any confidential client information obtained in their professional capacity. Frank has violated this tenant of the *Confidential Client Information Rule* in this scenario.]
 - c. **Phoebe treats spouses as one client when it comes to sharing information but treats an engaging entity as a separate client from a related beneficiary.** [This answer is correct. As outlined in the *Confidential Client Information Rule*, both spouses become the client when a member is retained by one of the spouses to prepare a joint tax return, even if the member deals exclusively with one spouse. The member may provide joint tax information to both spouses. When a person or entity engages a member to perform services (engaging entity) for another person or entity (beneficiary), the engaging entity and the beneficiary are considered two separate clients. The member may not share confidential client information of either client with the other without the consent of the client whose confidential information is to be shared. Therefore, Phoebe has correctly interpreted the guidance in this scenario.]
 - d. Mike discloses confidential client information to his third-party service provider. [This answer is incorrect. Before disclosing this information, according to the *Confidential Client Information Rule*, Mike needs to (1) enter into a contractual agreement with the third-party service provider about said information and (2) obtain specific consent from the client. As the scenario does not clarify that Mike has done either of those things, he has violated the Rule.]

7. Which of the following is required by the Interpretations of the *Form of Organization and Name Rule*?
(Page 153)

- a. All members of a firm must call themselves partners. [This answer is incorrect. According to the Interpretations of the *Form of Organization and Name Rule*, members of a firm who are not legally partners should *not* use the designation of *partner* and should *not* hold themselves out in any manner that might lead clients or the public to believe that they are partners.]
- b. Former partners must assign the CPA partner any joint attest engagements. [This answer is incorrect. Per the Interpretations of the *Form of Organization and Name Rule*, two former partners *may continue* to jointly perform an attest engagement, even if one of them is not a CPA, except when applicable laws, rules, or regulations conclude otherwise.]
- c. Retired partners' names must be removed from the firm's name. [This answer is incorrect. As outlined in the Interpretations of the *Form of Organization and Name Rule*, former partners' names *may be* used in a firm's name. For example, if two firms merge, the new firm may include the names of retired or other partners from either or both of the merged firms in its name.]
- d. **CPAs must own the majority of the financial interests in a firm performing attest services.** [This answer is correct. An AICPA Council resolution related to the *Form of Organization and Name Rule* requires that CPAs own a majority of the financial interests of a firm engaged in attest services and remain responsible, financially and otherwise, for attest work performed.]

INDEPENDENCE REQUIREMENTS THAT MUST BE CONSIDERED

The *Independence Rule* and Related Interpretations

The *Independence Rule* of the AICPA *Code of Professional Conduct* (ET 1.200.001) states that, when performing professional services, members in public practice shall be independent as required by applicable professional standards. Independence is the aspect of relevant ethical requirements that has traditionally received the most attention because practitioners are required to be independent in order to perform attest services. Performing attest services when independence is lacking will cause negative consequences for the firm and the nonindependent practitioner. Independence is not only required by the Code and QC 10, but by other authoritative pronouncements (such as the compilation and review, attestation, and auditing standards of the AICPA), as well as other regulatory organizations. Complying with the independence requirements of the Code ensures that the related independence requirements of quality control, compilation and review, attestation, and auditing standards of the AICPA are met.

The independence requirements of state boards of accountancy, state CPA societies, the PCAOB, the SEC, the DOL, the GAO, and other regulatory organizations may be different from and more restrictive than those of the AICPA and should be consulted as applicable. AICPA members are required to also follow other regulatory organization independence requirements when performing relevant services.

Exhibit 1-7 presents a listing of the independence interpretation topics included in the Code. Most of the topics include multiple subtopics, but in this exhibit only the *Nonattest Services* topic has been detailed to that level. For each topic (or subtopic), the pertinent Code references are also listed. In the absence of an independence interpretation that addresses a specific relationship or circumstance, firms should follow the guidance in the *Conceptual Framework for Independence*, discussed later in this section.

Exhibit 1-7

Independence Interpretations^a

Topic of Independence Interpretation	Code Reference
Accounting Firms	ET 1.220
Affiliates, Including State and Local Government Affiliates ^b	ET 1.224
Reissued Reports	ET 1.226
Engagement Contractual Terms	ET 1.228
Fees ^c	ET 1.230
Financial Interests	ET 1.240
Trusts and Estates	ET 1.245
Participation in Employee Benefit Plans	ET 1.250
Depository, Brokerage, and Other Accounts	ET 1.255

Topic of Independence Interpretation	Code Reference
Insurance Products	ET 1.257
Loans, Leases, and Guarantees ^d	ET 1.260
Business Relationships	ET 1.265
Family Relationships With Attest Clients ^e	ET 1.270
Current Employment or Association With an Attest Client ^f	ET 1.275
Former Employment or Association With an Attest Client	ET 1.277
Considering or Subsequent Employment or Association With an Attest Client	ET 1.279
Memberships	ET 1.280
Gifts and Entertainment	ET 1.285
Actual or Threatened Litigation	ET 1.290
Nonattest Services:	
Scope and Applicability	ET 1.295.010
Cumulative Effect on Independence When Providing Multiple Nonattest Services	ET 1.295.020
Management Responsibilities	ET 1.295.030
General Requirements	ET 1.295.040
Documentation Requirements	ET 1.295.050
Advisory Services	ET 1.295.105
Appraisal, Valuation, and Actuarial Services	ET 1.295.110
Accounting Standards Implementation Services ^g	ET 1.295.113
Benefit Plan Administration	ET 1.295.115
Bookkeeping, Payroll, and Other Disbursements	ET 1.295.120
Business Risk Consulting	ET 1.295.125
Corporate Finance Consulting	ET 1.295.130
Executive or Employee Recruiting	ET 1.295.135
Forensic Accounting	ET 1.295.140

Topic of Independence Interpretation	Code Reference
Hosting Services	ET 1.295.143
Information Systems Design, Implementation, or Integration ^h	ET 1.295.145
Internal Audit	ET 1.295.150
Investment Advisory or Management	ET 1.295.155
Tax Services	ET 1.295.160
Independence Standards for Engagements Performed in Accordance With SSAEs	ET 1.297
Breach of an Independence Interpretation	ET 1.298

Notes:

- ^a All independence interpretation topics are presented at the summary level with the exception of the Nonattest Services topic. Certain of the independence interpretations and revisions are discussed in this section.
- ^b There are recently effective revisions to ET 1.224.020 and ET 1.224.010.
- ^c The revised *Unpaid Fees* interpretation (ET 1.230.010) was approved for issuance on February 16, 2022.
- ^d PEEC approved revisions to ET 1.260.010 and ET 1.260.020 on February 16, 2022.
- ^e PEEC approved revisions to ET 1.270.010 on February 16, 2022.
- ^f The new interpretation, *Staff Augmentation Arrangements* (ET 1.275.007), is effective as of November 30, 2021.
- ^g PEEC approved a new interpretation for issuance on February 16, 2022. It will be effective six months after notice is published in the *Journal of Accountancy*.
- ^h PEEC issued a revised interpretation, *Information System Services*, effective on January 1, 2023.

The Conceptual Framework for Independence

The *Conceptual Framework for Independence* (ET 1.210.010) is applicable only to members in public practice. It should be used when making independence decisions on independence matters that are not explicitly addressed in the Code. When there is not an interpretation that is applicable to a particular relationship or circumstance, the member should evaluate whether the relationship or circumstance would lead a reasonable and informed third party who is aware of the relevant facts to conclude that there is a threat to the member's and/or firm's independence that is not at an acceptable level. All such threats must be eliminated or reduced to an acceptable level in order for the member to be independent. However, the *Conceptual Framework for Independence* may not be used to overcome prohibitions or requirements contained in the independence interpretations.

Application of the *Conceptual Framework for Independence* is similar to that of the *Conceptual Framework for Members in Public Practice*, except that there is an additional requirement for members to document the identified threats and the safeguards applied. Failure to prepare the required documentation would be considered a violation of the *Compliance With Standards Rule*, not the *Independence Rule*, provided that the member can demonstrate that

significant threats were eliminated or reduced to an acceptable level by the safeguards that were applied. The *Conceptual Framework for Members in Public Practice* was discussed earlier in this lesson.

The *Conceptual Framework for Independence* identifies the same broad categories of threats and safeguards as the *Conceptual Framework for Members in Public Practice*. While the *Conceptual Framework for Independence* provides the same examples of safeguards as the *Conceptual Framework for Members in Public Practice*, it provides different examples of threats to independence. Those examples of threats to independence can be found in the Code at ET 1.210.010.12–.18, some of which include the following:

- *Adverse Interest Threat*—Whether the member will not act with objectivity because the member's interests and those of an attest client are in opposition. For example, the member or an attest client commences litigation against the other, or expresses intent to do so.
- *Advocacy Threat*—Whether a member's independence is compromised due to promoting an attest client's interests or position. For example, the member promotes an attest client's securities as part of an initial public offering.
- *Familiarity Threat*—Whether a member will become too sympathetic to an attest client's interests or too accepting of the attest client's work or product due to having a long or close relationship with the client. For example, a member of the attest engagement team has an immediate family member, close relative, or close friend in a key position at the attest client.
- *Management Participation Threat*—Whether a member will act as management or otherwise assume management responsibilities for an attest client. For example, the member is an officer or director of the attest client.
- *Self-interest Threat*—Whether a member could benefit, financially or otherwise, from an interest in or relationship with an attest client or individuals associated with an attest client. For example, the member has a direct or material indirect financial interest in the attest client.
- *Self-review Threat*—Whether a member (a) will not appropriately evaluate the results of a judgment made or service performed or supervised by the member or someone else in the firm, and (b) will rely on that service when making a judgment as part of an attest engagement. Certain self-review threats, such as preparing source documents used to generate an attest client's financial statements, are so significant that no safeguards can eliminate the threats or reduce them to an acceptable level.
- *Undue Influence Threat*—Whether a member will subordinate their judgment to that of someone associated with an attest client or any relevant third party because of that person's reputation, expertise, aggressive or dominant personality, or attempts to coerce or exercise excessive influence over the member. For example, management threatens to replace the member or firm due to a disagreement over application of an accounting principle.

Ethical Conflicts. The Code indicates that the ethical conflicts guidance should be considered when obstacles arise that hinder the member from following an appropriate course of action (ET 1.200.005.03). Such obstacles may result from internal or external pressures and/or conflicts in applying relevant professional standards or legal standards. Applying the ethical conflicts guidance was discussed earlier in this lesson.

AICPA Conceptual Framework Toolkit for Independence. The AICPA provides a toolkit to assist members in implementing the *Conceptual Framework for Independence*. The toolkit includes a flowchart illustrating the steps of the conceptual framework; a worksheet to assist with applying the steps of the conceptual framework that could be used to satisfy the documentation requirements of ET 1.210.010.09; an example of a completed conceptual framework worksheet; and additional conceptual framework examples of situations that members may encounter that the Code does not address. The toolkit is available at us.aicpa.org/InterestAreas/ProfessionalEthics/Resources.

Effect on Independence of Performing Nonattest Services for an Attest Client

The *Nonattest Services* Interpretation sets requirements for remaining independent of an attest client, as well as for completing the engagement when performing nonattest services for the client. It also identifies nonattest services that would and would not impair independence. Consulting services, preparing financial statements, and tax compliance services typically are nonattest services.

The Interpretation incorporates by reference the independence requirements of other authoritative bodies (ET 1.295.010.07). It states that failure to meet more restrictive independence requirements of regulatory bodies (such as the SEC, PCAOB, GAO, DOL, and state boards of accountancy) to which the member is subject constitutes a violation of the Interpretation. For example, the SEC and PCAOB rules are more restrictive with respect to providing nonattest services that impair the independence of auditors of public companies. Additionally, the independence rules in the GAO's *Government Auditing Standards* are more restrictive with respect to providing nonattest services that impair the independence of auditors of governmental and nonprofit organizations that receive federal financial assistance or are otherwise subject to those requirements.

Scope and Applicability of Nonattest Services. Before AICPA members perform nonattest services for attest clients, they should determine and document that the requirements of the *Nonattest Services* Interpretation have been met. (Peer reviewers consider how the firm determined whether it was independent when it performs nonattest services for an attest client and they may challenge whether the firm was independent if it is not clear that the firm considered the effect on its independence of performing those nonattest services. Further information on the documentation requirements required when providing nonattest services to attest clients is provided later in this section.) The Interpretation requires the following with respect to the performance of nonattest services for attest clients:

- The member should not assume management responsibilities for the attest client.
- The attest client must agree to perform certain specific functions in connection with the nonattest services.
- The member should establish and document in writing the understanding with the attest client regarding the nonattest services.

If the requirements of the *Nonattest Services* Interpretation have not been met during the period of the professional attest engagement or the period covered by the financial statements, independence is considered impaired *unless, for nonattest services performed during the period covered by the financial statements—*

- a. The nonattest services were provided before the period of the professional engagement;
- b. The nonattest services related to periods prior to that of the financial statements; and
- c. Another firm audited (examined or reviewed, in the case of an examination or review) the financial statements for the period to which the nonattest services relate.

It is important to note that the *period of the professional engagement* is defined by the Code as continuing for the duration of the professional relationship, which often covers many periods, and ending with the formal or informal notification (either by the member or the client) of the termination of the professional relationship or the issuance of a report, whichever is later. Thus, the period does not end with the issuance of a report and recommence with the beginning of next year's attest engagement. Instead, the member should remain independent throughout the relationship until the period of professional engagement has ended.

During an attest engagement, the member often communicates with management about a variety of issues related to the engagement. The following are considered normal communications in an attest engagement and would not be subject to the Interpretation:

- The attest client's selection and application of accounting standards or policies and financial statement disclosure requirements.
- Whether the attest client's accounting and financial reporting methods are appropriate.

- Adjusting journal entries proposed or prepared by the member for management's consideration.
- The form or content of the financial statements.

The Code cautions members to consider whether the level of involvement constitutes a separate nonattest service. For example, activities such as financial statement preparation, cash-to-accrual conversions, reconciliations, preparing tax returns, and some bookkeeping services are considered outside the scope of an attest engagement and are, instead, nonattest services. However, such activities would not impair independence provided the requirements of the *Nonattest Services* Interpretation are met.

Cumulative Effect When Providing Multiple Nonattest Services. Although performing an individual nonattest service might not impair independence, the cumulative effect of multiple nonattest services may increase the significance of threats to independence. Before agreeing to perform the services, the member should evaluate whether the aggregate effect of performing multiple nonattest services results in a significant threat to independence that cannot be reduced to an acceptable level by applying the safeguards in the *General Requirements for Performing Nonattest Services* Interpretation. If the member determines that threats are not at an acceptable level, additional safeguards should be applied to eliminate the threats or reduce them to an acceptable level. If there are no safeguards that eliminate the threat or reduce it to an acceptable level, the member's independence would be impaired. It is not necessary to consider threats that might be created when other network firms within the member's firm network provide nonattest services. It is important to document the firm's determination of how independence is maintained when performing nonattest services for attest clients, as further discussed beginning below.

General Requirements for Performing Nonattest Services. Provided that an interpretation does not state otherwise, performing nonattest services for an attest client will not impair a member's independence if *all* of the following safeguards are met:

- The member determines that the attest client and its management agree to—
 - Assume all management responsibilities.
 - Oversee the services by designating an individual, preferably within senior management, who possesses suitable skill, knowledge, or experience. The member should assess the designated individual and be satisfied that the individual sufficiently understands the services to be performed to oversee them. However, the designated individual does not have to possess the expertise necessary to perform the services.
 - Evaluate the adequacy and results of the services performed.
 - Accept responsibility for the results of the services.

Additionally, the member needs to be satisfied that the attest client and its management will be able to meet all these criteria, make an informed judgment on the results of the nonattest services, and be responsible for making the significant judgments and decisions that are properly management's responsibility. The member's independence would be impaired if the attest client is unable or unwilling to assume these responsibilities.

- Before performing nonattest services, the member *establishes* and *documents in writing* an understanding with the attest client about the objectives and any limitations of the nonattest services engagement, the services to be performed, the attest client's acceptance of its responsibilities, and the member's responsibilities.

Documentation Requirements When Providing Nonattest Services. Before performing a nonattest service, the member should document in writing with the attest client the understanding about the objectives of the engagement, the services to be performed, the client's acceptance of its responsibilities, the member's responsibilities, and any limitation of the engagement. The understanding may be with the client's board of directors, audit committee, or management, as appropriate. The *Nonattest Services* Interpretation does not specify any particular form of documentation, such as an engagement letter, but leaves the form to the member's discretion as long as the documentation clearly articulates the matters required to be documented.

The AICPA provided further explanatory information in the July 2018 Peer Reviewer Alert, indicating that, while the *Nonattest Services* interpretation does not specify the extent of the documentation, auditors should consider whether the firm's documentation complies with AU-C 230. Additionally, the AICPA suggests that firms consider whether the documentation needs to provide details about the member of client management who will oversee the nonattest services (and that person's skill, knowledge, or experience), as well as the firm's assessment of the ability of that person to oversee the nonattest services.

If the member establishes the required understanding with the attest client but fails to prepare the required documentation of such understanding, the failure would be a violation of the *Compliance With Standards Rule*, not an independence impairment. However, the AICPA peer review engagement checklists indicate that when the firm has not complied with the documentation requirement, convincing evidence must be provided in order to enable the peer reviewer to conclude that an independence impairment does not exist. This documentation requirement does not apply to nonattest services performed prior to the period of the professional engagement for an attest client. However, after accepting the attest engagement, the member should document their compliance with the other general requirements, including the requirement to establish an understanding with the attest client.

Additionally, the peer review engagement questionnaires that firms are required to complete for each engagement selected for review ask specific questions about complying with the requirements of ET 1.295.040.01, including (a) identification of the individual in the firm responsible for assessing the specific nonattest service, (b) the name and title of attest client personnel designated to oversee the nonattest service, and (c) description of the firm's assessment and factors leading to the firm's satisfaction that the client personnel possessed sufficient skills, knowledge, or experience to oversee the nonattest service. During 2018, the AICPA made changes to the peer review audit engagement questionnaires to more closely align the wording of the nonattest services questions to the language in the Code.

Many PPC attest engagement guides provide a form that can be used to document compliance with the requirements of the *Nonattest Services* Interpretation, including the assessment made by the firm to satisfy those requirements, as discussed in the previous paragraph. This form also provides a means to reference to where the firm has documented in writing the required understanding with the attest client regarding the nonattest services, and may also be used to document compliance with the requirements of the interpretation for nonattest services that are added after the engagement has begun. The AICPA has a nonattest services FAQ document, *Frequently Asked Questions: Nonattest Services Questions*, that provides additional guidance on documentation of the understanding with the attest client, as well as the suitable skill, knowledge, or experience of the designated individual overseeing the nonattest service. The FAQ document can be found at us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/nonattestservicesfaqs.pdf.

Activities That Impair Independence. Certain activities performed as part of a nonattest service are considered to be management responsibilities and, therefore, impair independence, regardless of whether the member complies with the other requirements of the *Nonattest Services* Interpretation. If the member assumes a management responsibility for an attest client, the management participation threat created would be so significant that no safeguards could reduce the threat to an acceptable level and the member's independence would be impaired. Management responsibilities involve leading and directing an entity, including making significant decisions about the acquisition, deployment, and control of human, financial, physical, and intangible resources. Performance of the following activities would generally be considered a management responsibility and impair independence if performed for an attest client:

- Setting policies or strategic direction for the client.
- Directing or accepting responsibility for the actions of the client's employees, except to the extent permitted by auditing and attestation standards when using the assistance of internal auditors.
- Authorizing, executing, or consummating transactions, or otherwise exercising authority on behalf of the client, or having the authority to do so.
- Preparing source documents evidencing a transaction.
- Having custody of client assets.

- Deciding which of the member's or other third party's recommendations to implement or prioritize.
- Reporting to those charged with governance on behalf of management.
- Serving as a client's stock transfer or escrow agent, registrar, general counsel, or its equivalent.
- Accepting responsibility for the management of a client's project.
- Accepting responsibility for the preparation and fair presentation of the client's financial statements.
- Accepting responsibility for designing, implementing, or maintaining internal control.
- Performing ongoing evaluations of the client's internal control as part of the client's monitoring activities.

Exhibit 1-8 presents the examples provided in the *Nonattest Services* Interpretation that would and would not impair independence.

Exhibit 1-8

Impact on Independence of Performance of Nonattest Services

Type of Nonattest Service	Independence Would Not Be Impaired ^a	Independence Would Be Impaired
Advisory services (ET 1.295.105)	<ul style="list-style-type: none"> • Provide management with advice, research materials, and recommendations to help it carry out managerial functions and make decisions. • Attend board meetings in a nonvoting advisory capacity. • Interpret financial statements, forecasts, or other analyses. • Advise management regarding its potential plans, strategies, or relationships. 	<ul style="list-style-type: none"> • Assume any management responsibilities.
Appraisal, valuation, and actuarial services (ET 1.295.110)	<ul style="list-style-type: none"> • Perform actuarial valuations of pension or postemployment benefit liabilities that do not involve a significant degree of subjectivity. • Perform services for nonfinancial statement purposes, such as for tax planning or tax compliance, estate and gift taxation, and divorce proceedings. 	<ul style="list-style-type: none"> • Perform appraisal, valuation, or actuarial services in which the service is material to the financial statements and involves a significant degree of subjectivity (e.g., ESOPs, business combinations, or asset or liability appraisals).
Benefit plan administration (ET 1.295.115)	<ul style="list-style-type: none"> • Communicate summary plan data to plan trustee. • Advise management on the application or impact of provisions of the plan 	<ul style="list-style-type: none"> • Make policy decisions on behalf of client management. • When dealing with plan participants, interpret the plan

Type of Nonattest Service	Independence Would Not Be Impaired ^a	Independence Would Be Impaired
	<p>document.</p> <ul style="list-style-type: none"> • Process transactions (e.g., investment/benefit elections or increase/decrease contributions to the plan; data entry; participant confirmations; and the processing of distributions and loans) initiated by plan participants or approved by the plan administrator using the member's electronic media, such as an interactive voice response system or Internet connection or other media. • Prepare account valuations for plan participants using data collected through the member's electronic or other media. • Prepare and transmit participant statements to plan participants based on data collected through the member's electronic or other media. 	<p>document on behalf of management without first obtaining management's concurrence.</p> <ul style="list-style-type: none"> • Make disbursements on behalf of the plan. • Have custody of assets of a plan. • Serve a plan as a fiduciary as defined by ERISA.
Bookkeeping, payroll, and other disbursements (ET 1.295.120)	<ul style="list-style-type: none"> • Record transactions for which management has determined or approved the appropriate account classification, or post transactions coded by the attest client to the attest client's general ledger. • Prepare financial statements based on information in the trial balance. • Post client-approved entries to an attest client's trial balance. • Prepare a reconciliation (for example, bank, accounts receivable) that identifies reconciling items for the client's evaluation. • Propose standard, adjusting, or correcting journal entries or other changes 	<ul style="list-style-type: none"> • Determine or change journal entries, account codings or classification for transactions, or other accounting records without the attest client's approval. • Authorize or approve transactions. • Prepare source documents. • Change source documents without the attest client's approval. • Accept responsibility to authorize payment of attest client funds, electronically or

Type of Nonattest Service	Independence Would Not Be Impaired ^a	Independence Would Be Impaired
Business risk consulting (ET 1.295.125)	<p>affecting the financial statements to the attest client provided the client reviews the entries and the member is satisfied that management understands the nature of the proposed entries and the impact the entries have on the financial statements.</p> <ul style="list-style-type: none"> • Generate unsigned checks using source documents or other records provided and approved by the attest client. • Process payroll using payroll time records provided and approved by the attest client. • Transmit client-approved payroll or other disbursement information to a financial institution, provided the client has reviewed the information, authorized the member to make the transmission, and made arrangements for the financial institution to limit the corresponding individual payments as to amount and payee. In addition, once transmitted, the client must authorize the financial institution to process the information. • Provide assistance in assessing the attest client's business risk control processes. • Recommend improvements to the business risk control processes and assist in implementing the improvements. 	<p>otherwise, except as specifically provided for with respect to electronic payroll tax payments.</p> <ul style="list-style-type: none"> • Accept responsibility to sign or cosign attest client checks, even in an emergency situation. • Maintain an attest client's bank account or otherwise have custody of the client's funds or make credit or banking decisions for the client. • Approve vendor invoices for payment. • Make or approve business risk decisions. • Communicate business risk considerations to the board or others on management's behalf.

Type of Nonattest Service	Independence Would Not Be Impaired ^a	Independence Would Be Impaired
Corporate finance consulting (ET 1.295.130)	<ul style="list-style-type: none"> • Assist in developing corporate strategies. • Assist in identifying or introducing the attest client to possible sources of capital that meet the client's specifications or criteria. • Assist the attest client in analyzing the effects of proposed transactions, including providing advice during negotiations with potential buyers, sellers, or capital sources. • Assist in drafting an offering document or memorandum. • Participate in transaction negotiations in an advisory capacity. • Be named as a financial advisor in a private placement memoranda or offering documents. 	<ul style="list-style-type: none"> • Commit the attest client to the terms of a transaction or consummate a transaction on the client's behalf. • Act as a promoter underwriter, broker-dealer, or guarantor of an attest client's securities, or distributor of private placement memoranda or offering documents. • Have custody of an attest client's securities.
Executive or employee recruiting (ET 1.295.135)	<ul style="list-style-type: none"> • Recommend a position description or candidate specifications. • Solicit and perform screening of candidates and recommend qualified candidates based on criteria approved by the attest client (e.g., required education, skills, or experience). • Participate as an advisor in employee hiring or compensation discussions. 	<ul style="list-style-type: none"> • Commit the attest client to compensation or benefits. • Hire or terminate attest client employees.
Forensic accounting (ET 1.295.140)	<ul style="list-style-type: none"> • Provide expert witness services for a large group of plaintiffs or defendants that includes attest clients, assuming the attest clients represent less than 20% of the group, the voting interests of the group, and the claim; no attest client in the group is the lead plaintiff or defendant; and no attest client has the sole decision-making power to select or approve the expert witness. 	<ul style="list-style-type: none"> • Provide expert witness services or expert testimony for an attest client. • Serve as a trier of fact, special master, court-appointed expert, or arbitrator in a matter involving an attest client.

Type of Nonattest Service	Independence Would Not Be Impaired ^a	Independence Would Be Impaired
Hosting services (ET 1.295.143)	<ul style="list-style-type: none"> • Provide investigative services for an attest client. • Provide litigation consulting services for an attest client by giving advice about the facts, issues, and strategy of a matter. • Serve as a mediator or in a similar role in a matter involving an attest client by assisting the parties to reach their own agreement and not making decisions on behalf of the parties. 	
	<ul style="list-style-type: none"> • Keep a copy of the data or records of the attest client to support a service provided to the attest client (such as payroll data supporting a payroll tax return prepared by the accountant, a bank reconciliation supporting attest procedures performed on the client's cash account, and client vendor data used in analyzing vendor activity). • Keep a copy of the work product (such as tax returns prepared) for the attest client. • Use general ledger software to perform bookkeeping services for an attest client, provided one of the following occurs: (a) the accountant and the client keep separate instances of the software on their respective servers and the accountant gives updated financial information to the attest client electronically, or (b) a third-party service provider maintains the attest client's software in the cloud and the accountant is granted access to the software in order to perform bookkeeping services for the attest client. 	<ul style="list-style-type: none"> • House the website or other nonfinancial information system. • Provide business continuity or disaster services. • Store the attest client's records (such as general ledger information, depreciation or amortization schedules, or lease schedules).

Type of Nonattest Service	Independence Would Not Be Impaired ^a	Independence Would Be Impaired
	<ul style="list-style-type: none"> • Keep a copy of a depreciation schedule the accountant prepared, as long as the schedule and calculation are provided to the attest client so their books and records are complete. • Electronically exchange records, data, or a work product with, or on behalf of, the attest client at the request of the client. • License software to an attest client that the client uses to input data and provide output from the software to the accountant, as long as the software does not perform an activity that would impair independence. • Retain original attest client data or records to help perform a nonattest service, as long as the data or records are returned at the completion of the engagement. 	
Information systems—design, implementation, or integration (ET 1.295.145)	<ul style="list-style-type: none"> • Install or integrate an attest client's financial information system, that was not designed or developed by the member (for example, an off-the-shelf accounting package). • Assist in setting up the chart of accounts and financial statement format for an attest client's financial information system. • Design, develop, install, or integrate an information system that is not related to the financial statements or accounting records. • Train and instruct an attest client's employees on an information and control system. • At management's request, perform routine network 	<ul style="list-style-type: none"> • Design or develop a financial information system for an attest client. • Make other than insignificant modifications to source code underlying an existing financial information system. • Supervise attest client personnel in the daily operation of the information system. • Operate an attest client's network.

Type of Nonattest Service	Independence Would Not Be Impaired ^a	Independence Would Be Impaired
Internal audit (ET 1.295.150)	<p data-bbox="683 247 1013 373">maintenance, such as updating virus protection, applying updates and patches, or configuring user settings.</p> <ul data-bbox="656 394 1013 1640" style="list-style-type: none"> <li data-bbox="656 394 1013 961">• Assist in performing financial and operational internal audit activities for an attest client, provided that management designates an individual with suitable skill, knowledge, and/or experience to be responsible for the internal audit function; determine the scope, risk, and frequency of internal audit activities; evaluate the findings and results from the internal audit activities; and evaluate the adequacy of the audit procedures performed and the findings from those procedures. <li data-bbox="656 972 1013 1318">• Assist in performing preliminary audit risk assessments, preparing audit plans, and recommending audit priorities for an attest client, so long as those charged with governance are informed about the member's and management's respective roles and responsibilities. <li data-bbox="656 1329 1013 1640">• Perform engagements under the attestation standards to report on management's assertion regarding the effectiveness of internal controls for an attest client, provided that management does not rely on the member's work as the primary basis for its assertion. 	<ul data-bbox="1062 394 1419 1887" style="list-style-type: none"> <li data-bbox="1062 394 1419 552">• Perform an attest client's internal audit function such that the member, in effect, manages the internal audit activities. <li data-bbox="1062 562 1419 846">• Perform ongoing monitoring activities, control activities that affect transactions and/or ensure that transactions are properly executed or accounted for, or other activities that equate to a compliance or quality control function. <li data-bbox="1062 856 1419 1098">• Perform separate evaluations of a significant control's effectiveness such that, in effect, routine activities that are part of the attest client's business process are being performed. <li data-bbox="1062 1108 1419 1297">• Have management rely on the member's work as the primary basis for assertions about the design or operating effectiveness of internal controls. <li data-bbox="1062 1308 1419 1434">• Determine which recommendations for control system improvement should be implemented. <li data-bbox="1062 1444 1419 1602">• Report to the board of directors or audit committee on behalf of management or the internal audit function. <li data-bbox="1062 1665 1419 1759">• Approve or be responsible for the overall internal audit work plan. <li data-bbox="1062 1770 1419 1887">• Be connected with the attest client as an employee or management equivalent (for example, being listed as

Type of Nonattest Service	Independence Would Not Be Impaired ^a	Independence Would Be Impaired
Investment advisory or management (ET 1.295.155)	<ul style="list-style-type: none"> • Recommend the allocation of funds that should be invested in various investments or asset classes, depending upon the attest client's desired rate of return, risk tolerance, etc. • Perform recordkeeping and reporting of portfolio balances including providing a comparative analysis of investments to those of third-party benchmarks. • Evaluate the manner in which a portfolio is being managed by investment account managers, including determining whether the managers are (a) following the attest client's investment guidelines; (b) meeting the investment objectives; and (c) conforming to the stated investment parameters or risk tolerance. • Transmit an investment client's investment selection to a broker-dealer or equivalent if the client has authorized execution of the transaction. 	<p>an employee in client directories or other publications, or being referred to as being in charge of the internal audit function).</p> <ul style="list-style-type: none"> • Make investment decisions on behalf of management or otherwise have discretionary authority over investments. • Execute transactions to buy or sell investments for an attest client. • Have custody of an attest client's assets, such as temporarily possessing securities purchased by the client.
Tax services (ET 1.295.160)	<ul style="list-style-type: none"> • Prepare a tax return and transmit the tax return and related payment to a taxing authority in paper or electronic form, provided that (a) the member does not have custody or control over the attest client's funds or assets and (b) the individual designated by the client to oversee the tax services reviews and approves the tax return and related payment and signs 	<ul style="list-style-type: none"> • Represent an attest client in a court to resolve a tax dispute.

Type of Nonattest Service	Independence Would Not Be Impaired ^a	Independence Would Be Impaired
	<p>the tax return prior to member transmission.</p> <ul style="list-style-type: none"> • Sign and file a tax return on behalf of management, provided that the member has the legal authority to do so and the taxing authority has prescribed procedures in place to permit a member to sign and file a tax return on its behalf (for example, Forms 8879 or 8453), and such procedures meet standards for electronic return originators and officers outlined in Form 8879; or an individual in management who is authorized to sign and file the tax return provides the member with a signed statement that clearly identifies the return being filed, and represents that the individual (a) is authorized to sign and file the tax return; (b) has reviewed the tax return, including accompanying schedules and statements, and it is true, correct, and complete to the best of the individual's knowledge and belief; and (c) authorizes the member or another named individual in the member's firm to sign and file the tax return on the client's behalf. 	

Type of Nonattest Service	Independence Would Not Be Impaired ^a	Independence Would Be Impaired
	<ul style="list-style-type: none"> • Serve as the attest client's authorized representative in administrative proceedings before a taxing authority, provided that the client's agreement is obtained prior to committing to a specific resolution with the taxing authority. • Use an attest client's power of attorney that is limited strictly to tax matters and does not bind the client to any agreement with a taxing authority or other regulatory agency. 	

Note:

- ^a When performing these services, independence would not be impaired if the requirements of ET 1.295 are met.

Review Nonattest Services Performed for an Attest Client for Possible Independence Problems. The engagement partner assigned to each client is usually aware of all services being performed for that client. Accordingly, the authors believe that the engagement partner is generally also assigned the primary responsibility for identifying all such services, including nonattest services, and determining if such services impair independence with respect to an attest client. This identification and determination needs to be performed before each nonattest and attest engagement is performed, including compilation engagements. PPC engagement work programs for all attest engagements include steps to ensure compliance with this procedure. (Although a compilation engagement does not require an accountant to be independent of a client for whom a compilation service is provided, the accountant's report must disclose the lack of independence.)

To ensure completeness of the attest engagement population for monitoring purposes, all firms need to maintain such a list. Many firms use their time and billing system to develop such a list.

The independence rules in the *Government Auditing Standards* also restrict nonaudit services that can be performed for an audit client. In several respects, those rules are more restrictive than the AICPA rules discussed in this section. GAO *Government Auditing Standards* rules are discussed in *PPC's Guide to Single Audits*, *PPC's Guide to Audits of Local Governments*, and *PPC's Guide to Audits of Nonprofit Organizations*.

AICPA Nonattest Services Toolkit. The AICPA provides a toolkit to assist members in understanding the independence requirements related to providing nonattest services and with evaluating threats to independence when providing those services. The toolkit includes explanatory information about nonattest services, an independence evaluation and monitoring flowchart, and a checklist to assist with evaluating whether independence would be impaired when providing nonattest services. The toolkit is available at us.aicpa.org/InterestAreas/ProfessionalEthics/Resources.

Recent Changes to Independence Requirements

The following paragraphs provide information about recently approved, effective, or proposed revisions to the Code that would affect independence (ET 1.200). The information presented is at a high level. Detailed information about the changes discussed here and other standards-related projects of the Professional Ethics Executive Committee

(PEEC) may be accessed from the AICPA's website at us.aicpa.org/content/aicpa/interestareas/professionalethics/community/peec-project-activity.html.

Recently Effective State and Local Government-related Ethics Guidance. In June 2019, PEEC issued a revised interpretation, *State and Local Government Client Affiliates* (formerly *Entities Included in State and Local Government Financial Statements*), which revises the guidance in ET 1.224.020. The revised interpretation increases the requirements for members to remain independent concerning affiliated entities and defines affiliated entities for purposes of independence. The revised interpretation extends independence requirements to certain instances when the member makes reference to another auditor's report as well as to certain circumstances where material related entities are excluded from the financial statements but are required to be included by the financial reporting framework. The member is also required to remain independent of investments that the attest client controls and material investments over which the attest client has significant influence. The revised interpretation was originally effective for years beginning after December 15, 2020, but due to the COVID-19 pandemic, the interpretation's effective date was delayed one year to years beginning after December 15, 2021. It is important to note that members must meet the amended independence requirements during the entire period of professional engagement (i.e., as early as January 1, 2022, for calendar year-end entities).

To assist firms in understanding and applying the new interpretation, PEEC has made available an implementation guide, which assists in identifying which entities are affiliates of the member's financial statement attest client, so that the member's firm can determine whether it is independent of those entities. Three other tools have also been made available to help identify whether an entity is an affiliate and if so, what type. Those resources are available from the AICPA's website at us.aicpa.org/interestareas/professionalethics/resources.

Finalized Information System Services Interpretation. In June 2019, PEEC issued a revised interpretation, *Information System Services* (formerly *Information Systems Design, Implementation, or Integration*) (ET 1.295.145). The revised interpretation provides clarifying guidance that addresses the circumstances under which certain threats to independence would or would not be at an acceptable level when a member provides nonattest services related to an attest client's information systems. The revised interpretation addresses the following nonattest services involving an attest client's information system or network:

- Design and development.
- Implementation, which includes installation, customization, integration interfacing, configuration, and data translation.
- System and network maintenance, support, and monitoring.

The revision incorporates several defined terms, including *financial information system*, which is key to avoiding self-review threats that impair independence. The revised interpretation was originally effective on January 1, 2021, but due to the COVID-19 pandemic, the effective date was changed to January 1, 2022. In November 2021, due to concerns from firms, PEEC agreed to delay the effective date for one more year to January 1, 2023, with early implementation allowed.

The additional year delay will be used for educational outreach. In December 2021, PEEC issued a practice aid, *Independence Considerations for Information System Services*, designed to help ensure firms are not breaching independence rules when they provide information system services. The practice aid is available at us.aicpa.org/interestareas/professionalethics.html from the "Spotlight" section or the "PEEC Project Activity" link.

Recently Effective Staff Augmentation Arrangements Interpretation. In February 2021, PEEC issued an interpretation, *Staff Augmentation Arrangements* (ET 1.275.007 under the "Current Employment or Association With an Attest Client" subtopic of the Independence Rule). [The original proposed interpretation had been issued in December 2018 under the "Nonattest Services" subtopic (at ET 1.295.157).] Some members and members' firms provide human resource capital as a service to clients under staff augmentation arrangements (also commonly referred to as *loaned staff*). The interpretation indicates that such arrangements will impair independence except when certain safeguards are in place. These safeguards include—

- The staff augmentation arrangement is being performed as a result of an unexpected situation that would create a significant hardship for the attest client to make different arrangements.

- The augmented staff arrangement is not expected to occur again.
- The augmented staff arrangement is performed for a short period of time only (believed to be less than 30 days).
- The augmented staff does not participate in, nor is the staff in a position to influence, an attest engagement for any periods that include the staff augmentation arrangement.
- The augmented staff does not perform any activities that would be prohibited by the *Nonattest Services* subtopic (ET 1.295) of the *Independence Rule* (ET 1.200.001).
- The member is satisfied that an individual(s) is designated by client management, and that individual(s) possesses suitable skill, knowledge, and/or experience, preferably within senior management, to be responsible for—
 - determining the nature and scope of the work that the augmented staff will provide,
 - supervising and overseeing the work that the augmented staff will perform, and
 - evaluating the adequacy of the work that will be performed by the augmented staff and the findings resulting from the work.

In conjunction with issuing the *Staff Augmentation Arrangements* interpretation, PEEC also approved revisions to the following interpretations:

- *Agreed-Upon Procedures Engagements Performed in Accordance With SSAEs* (ET 1.297.020), allowing staff augmentation arrangements if the services provided are unrelated to the agreed-upon procedures engagement's specific subject matter.
- *Client Affiliates* (ET 1.224.010), permitting staff augmentation arrangements with certain affiliates.
- *Scope and Applicability of Nonattest Services* (ET 1.295.010), to refer to the guidance in the new interpretation when such an arrangement exists.

The new interpretation and revisions to existing interpretations are effective as of November 30, 2021. The official release is available at us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2021/2021-March-staff-augmentation-official.pdf.

Approved *Unpaid Fees* Interpretation. In September 2021, PEEC issued an exposure draft that would revise the existing *Unpaid Fees* interpretation (ET 1.230.010) replacing the current one-year bright-line provision with a more principles-based framework that would use a threats and safeguards approach to determine when unpaid fees impair independence. On February 16, 2022, PEEC approved the interpretation for issuance. The revised interpretation provides a list of factors for a member to consider when evaluating threats to independence. The revised interpretation will be effective six months after notice is published in the *Journal of Accountancy*. Early implementation will be allowed.

Approved *Assisting Attest Clients With Implementing Accounting Standards* Interpretation. In September 2021, PEEC issued a proposed new independence interpretation, *Assisting Attest Clients with Implementing Accounting Standards* (ET 1.295.113), that falls beneath the *Nonattest Services* subtopic. On February 16, 2022, PEEC approved the interpretation for issuance. The new interpretation provides guidance for members when assisting their attest clients with implementing accounting standards and includes examples of activities that will and will not impair the member's independence. The new interpretation will be effective six months after notice is published in the *Journal of Accountancy*. Early implementation will be allowed.

Approved Revised Interpretations and Definition. In October 2021, as part of its convergence efforts, PEEC issued an exposure draft that proposed revisions to the definition of *beneficially owned* and revisions to four

independence interpretations. On February 16, 2022, PEEC approved the definition and interpretations for issuance. The affected independence interpretations are—

- *Client Affiliates* interpretation (ET 1.224.010).
- *Loans* interpretation (ET 1.260.010).
- *Loans and Leases With Lending Institutions* interpretation (ET 1.260.020).
- *Immediate Family Members* interpretation (ET 1.270.010).

The revised guidance will be effective six months after notice is published in the *Journal of Accountancy*. Early implementation will be allowed. Detailed information on the proposed changes is available on the AICPA's website at us.aicpa.org/interestareas/professionalethics/community/peec-project-activity.html. The official release will also be available on the same website.

Hosting Services Interpretation

Hosting Services (ET 1.295.143) is a relatively new independence interpretation that affects many firms (it became effective for engagement periods beginning on or after July 1, 2019). The interpretation indicates that hosting services are nonattest services that involve the AICPA member accepting responsibility for the following:

- a. Being the sole host of a financial or nonfinancial information system of an attest client.
- b. Having sole custody of or storing an attest client's data or records, and the data or records are not available to the attest client except from the member.
- c. Providing back-up services or other electronic security services for an attest client's data or records.

When an AICPA member provides any of the above services, the interpretation indicates that the member is maintaining the internal control over the attest client's data or records. Accordingly, a management participation threat to the member's compliance with the *Independence Rule* would not be at an acceptable level and no safeguards could reduce the threat to an acceptable level. Thus, the member's independence would be impaired.

The interpretation provides a list of hosting services activities that would and would not impair independence. Those activities are summarized in Exhibit 1-8.

PEEC has issued a listing of Frequently Asked Questions (FAQs) regarding nonattest services, including hosting services, available at us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/nonattestservicesfaqs.pdf. The FAQs, while not authoritative guidance, may provide assistance in understanding and applying the requirements of the related independence interpretation.

Unpaid Fees and Independence

A member's independence can be impaired by unpaid fees. Specifically, ET 1.230.010 indicates that independence will be considered to be impaired if fees (billed or unbilled) or a note receivable arising from such fees for professional services to an attest client rendered more than one year prior to the date of the current year's report remain unpaid when that report is released. (While the *Unpaid Fees* Interpretation does not indicate that the unpaid fee must be of a certain amount before it impairs independence, the authors believe that amounts that are clearly inconsequential would not impair independence.)

The engagement partner assigned to each attest client needs to be aware of not only the status of uncollected fees, but also of unbilled fees applicable to that client. Accordingly, the authors believe that the engagement partner (or the accountant in charge under the partner's supervision) should have the primary responsibility for determining if unpaid fees exist that would impair the firm's independence. The partner needs to determine that all prior year fees are collected *before* the current year's report is issued. An alternative to having each engagement partner monitor accounts receivable for each client is to assign the monitoring responsibility for the entire firm to one partner. Some

firms adopt both procedures. The firm could also consider reviewing the status of fees paid for selected engagements during its annual inspection. The firm's QC system policies and procedures need to include consideration of unpaid attest client fees to independence.

Additional AICPA Resources

The Code includes links to a variety of nonauthoritative information that provides additional guidance explaining certain sections of the Code. An online version of the Code is available at us.aicpa.org/research/standards/codeofconduct. In addition, the AICPA provides resources, publications, and recent developments on the topic of professional ethics on its website at us.aicpa.org/interestareas/professionalethics. One resource designed to provide an understanding of the Code's independence requirements is the *AICPA Plain English Guide to Independence*, which is currently available on the AICPA's website at us.aicpa.org/interestareas/professionalethics/resources/tools.html. Also available on the same website is a link to a FAQ document on general ethics questions that have been received by the AICPA Professional Ethics Division hotline over the years. Other information is also available at that website. Additionally, the AICPA Professional Ethics Division provides a podcast that highlights issues related to ethics and independence. The podcast episodes may be accessed at us.aicpa.org/interestareas/professionalethics/ethically-speaking.html.

Other Independence Requirements

Rules of State Boards of Accountancy and State Societies of CPAs. Most state boards of accountancy and CPA societies adopt the ethics rules of the AICPA as the same rules that govern practices within their states. However, practitioners need to know whether their state has particular rules that are different from those of the AICPA. Contact information for CPA associations and state boards of accountancy, by state, is available from the AICPA's website at us.aicpa.org/advocacy/state/statecontactinfo.

Independence under *Government Auditing Standards*. The U.S. Government Accountability Office (GAO) is responsible for issuing *Government Auditing Standards*, also known as the Yellow Book. Paragraph 3.18 of the Yellow Book requires that auditors and the audit organization be independent from the audited entity in all matters relating to the Yellow Book engagement. According to Paragraphs 3.20 and 3.23 of the Yellow Book, the auditor should be independent from an audited entity during both of the following periods of time:

- Any period of time that falls within the period covered by the financial statements or subject matter of the engagement.
- The entire period of the professional engagement, which begins when the auditor signs the engagement letter (or other agreement to perform an audit) or actually begins to perform an engagement, whichever is earlier.

The period of the professional engagement does not necessarily end when the report is issued. It spans the entire duration of the professional relationship (which, for recurring audits, could cover several periods) and ends with the notification by either party of the termination of the relationship or by issuance of a report, whichever is later.

The Yellow Book identifies specific nonaudit services that always impair independence and that auditors are prohibited from providing to audited entities. If a nonaudit service is not specifically prohibited, the auditor is required to assess its impact on independence using the Yellow Book's conceptual framework. Chapter 3 of the Yellow Book expands the conceptual framework approach for independence by making the requirements related to independence much clearer and adding guidance related to nonaudit services. Among other things, it establishes independence standards and provides guidance on independence for auditors conducting financial audits, attestation engagements, reviews of financial statements, and performance audits under the Yellow Book. Chapter 3 of the Yellow Book provides additional guidance related to independence and nonaudit services, including how auditors evaluate the nonaudit services they perform and whether the performance of those services creates significant threats that require safeguards to reduce those threats to an acceptable level. When nonaudit services are performed, an evaluation should be made to determine if the service creates a threat to independence, and the evaluation must be documented. Paragraph 3.88 of the Yellow Book notes that preparing financial statements in their entirety is generally a significant threat. The threat should be documented along with the safeguards. If the threat can not be lowered to an acceptable level, the auditor should decline to perform the service. The Yellow Book

independence standards 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*.

Other Regulatory Independence Rules. Practitioners performing engagements for certain government agencies must comply with independence rules that, in some instances, are more restrictive than the AICPA rules. For example, a firm that performs bookkeeping services for a HUD project or an employee benefit plan may not be considered independent of the project or plan by HUD or the Department of Labor, respectively, even though the firm could be independent under the AICPA requirements. Additional guidance regarding such regulatory independence rules is provided in *PPC's Guide to Single Audits*, *PPC's HUD Audits*, and *PPC's Guide to Employee Benefit Plans*.

Special Considerations—Audit Engagements

Group Audits. QC 10.22 indicates that the firm's independence requirements are to be communicated to others subject to those requirements. The *others* referred to will generally include other auditors who are engaged to perform services for a principal auditor. AU-C 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, provides guidance for performing group audits. *Group audits* are audits of group financial statements, which are financial statements that include the financial information of more than one component. A *component* is any entity or business activity for which group or component management prepares financial information that is required by accounting standards to be included in the group financial statements. Group financial statements include all of the following types of aggregations of financial information into financial statements:

- Parent company and one or more subsidiaries.
- Joint ventures.
- Investor and investee accounted for by the equity method.
- Variable interest entities that are required to be consolidated.
- Head office and one or more branches or divisions.
- Other combinations of entities or activities organized by function, process, product or service, or geographical location.

A *component auditor* is defined as an auditor who performs work on the financial information of a component that will be used as audit evidence for the group audit. Component auditors are not just *other auditors*. A component auditor may be part of the group engagement partner's firm, a network firm of the group auditor, or another auditing firm. Thus, even when firm offices other than the lead partner's office are involved in the audit, the requirements of AU-C 600 apply. Additionally, even when only one engagement team is involved, considerations such as understanding components, identifying significant components, and determining component materiality are relevant in all group audits. In other words, the group audit guidance applies to all audits of group financial statements, whether or not there are auditors involved who are not members of the group engagement team. An auditor who performs work on a component when the group engagement team will not use that work to provide audit evidence, however, is not considered a component auditor.

Before a group engagement team can make the decision to refer to a component auditor in the auditor's report, certain procedures should be performed. However, regardless of whether reference to a component auditor will be made in the auditor's report, the group engagement team should obtain an understanding of several things, including whether the component auditor is independent. Additionally, the component auditor should be requested to communicate to the group engagement team certain matters relevant to concluding on the group audit, including whether the component auditor has complied with relevant ethical requirements (including independence and professional competence).

The detailed requirements of AU-C 600 are extensive and beyond the scope of this course. However, a comprehensive discussion of when to refer to another auditor's work can be found in *PPC's Guide to Auditor's Reports* and *PPC's Guide to Audits of Nonpublic Companies*. Also, *PPC's Guide to Audits of Nonpublic Companies* and *PPC's Guide to Audits of Local Governments* contain sample independence confirmation requests and replies for

commercial entities and governmental units. These guides can be ordered by calling (800) 431-9025 or through the website at **tax.thomsonreuters.com**.

Special Considerations—Review Engagements under the SSARS

Using the Work of Others. According to AR-C 90.124, regardless of whether the accountant decides to make reference to the review of other accountants in the review report, the accountant should communicate with the other accountants who have audited or reviewed the financial statements of significant components and ascertain the following:

- a. The other accountants are aware that the division, branch, subsidiary, or other investee financial statements that have been audited or reviewed are to be included in the financial statements on which the accountant will report and the accountant will rely upon the other accountants' report.
- b. The other accountants are familiar with the applicable financial reporting framework and applicable professional standards (SSARS or GAAS) and will conduct the review or audit in accordance with such.
- c. The other accountants understand the independence and other ethical requirements pertaining to the engagement. Although not required by SSARS, the accountant may want to obtain a written confirmation of the other accountants' independence.
- d. Intercompany transactions and accounts will be reviewed for matters that might affect appropriate eliminations and matters affecting the uniformity of accounting practices among the components included in the financial statements will be reviewed.

AR-C 90.138 requires that the review engagement documentation include the communications with the other accountants listed in the previous paragraph.

When the accountant decides to use work of other accountants or experts in the course of the review engagement, AR-C 90.39 requires the accountant to ensure that the work performed is adequate for the accountant's purposes. If significant components (divisions, branches, subsidiaries, partnerships, or joint ventures in which the entity has a significant investment) are reviewed or audited by other accountants, AR-C 90.40 requires that the accountant obtain and read reports from the other accountants as a basis, in part, for the accountant's review report on the financial statements of the entity.

The omission of any reference to relying on compilation reports of other accountants suggests that it would be inappropriate for the accountant to base their review report on another accountant's compilation report of a significant component of the entity. The reason for this is that no assurances can be derived from another accountant's compilation report.

MAINTAINING A FIRM'S INDEPENDENCE

QC 10.21 requires that firms establish policies and procedures to provide reasonable assurance that the firm and its personnel comply with relevant ethical requirements. After stating that requirement, the remaining discussion of the relevant ethical requirements quality control element in QC 10 primarily focuses on independence. The following discussion addresses how firms can maintain independence.

Initial Thoughts

Choosing Not to Be Independent. Some firms may choose *not* to be independent for certain client relationships. Such a business decision may involve providing only compilation and nonattest services (including financial statement preparation) to clients that do not require the firm to maintain independence with respect to those clients. For example, in sole practitioner or small firms, the partners may choose to hold an ownership interest in a client's business, or the firm may generate significant revenue by providing controllership services. While those relationships would impair a firm's independence and, thus, limit the services a firm could provide, such a trade-off might be more desirable to both the client and the firm. In summary, a firm may choose to have independence policies and procedures flexible enough to allow occasional client relationships where the firm is not independent. Obviously, the

firm makes such a trade-off decision in full recognition that it will be unable to perform attest services for those clients that require independence.

Minor Independence Violations. Some firms believe that minor ethics violations, including those related to independence, can be ignored. Additionally, some firms believe such violations can be resolved any time before year-end. However, not taking an independence breach seriously or postponing the resolution of the violation until the firm has time to deal with it (generally after the engagement is completed or even after the report has been issued), can have serious repercussions for the firm and its reputation. The authors strongly encourage firms to treat all ethics violations with an equal degree of importance and to deal with all ethics violations promptly. As undesirable as it may seem to resign from an engagement or to step down to a compilation service because the firm is unable to satisfactorily resolve an ethical conflict, such an action is a better solution than performing a substandard engagement and potentially receiving a *pass with deficiencies* or *fail* peer review report.

QC Policies and Procedures for Maintaining Independence

General Requirements. QC 10 requires the firm's system of quality control to include policies and procedures to address each of the quality control elements. To ensure that relevant ethical requirements are being addressed, the firm should establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel, and, when applicable, others subject to independence requirements (including network firm personnel) maintain independence when required by relevant ethical requirements. Independence requirements are set forth in the Code's *Independence Rule* (ET 1.200.001) and the interpretations under the *Independence Rule*, as well as the rules of state boards of accountancy and applicable regulatory agencies.

Many threats to independence are specifically addressed in the interpretations under the Code's *Independence Rule*. For independence-related matters that are not explicitly addressed, AICPA members are required to apply the risk-based approach found in the *Conceptual Framework for Independence*. Information about independence requirements pursuant to the Code and the *Conceptual Framework for Independence* was provided earlier in this lesson.

QC 10.22 indicates that quality control policies and procedures related to maintaining independence should be designed to enable the firm to accomplish the following:

- a. Communicate independence requirements to its personnel and, when applicable, others subject to those independence requirements.
- b. Identify and evaluate circumstances and relationships that create threats to independence.
- c. Take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards. (See the discussion of the *Conceptual Framework for Independence* earlier in this lesson for more information about how to apply safeguards.) If effective safeguards cannot be applied, the firm should, if appropriate, withdraw from the engagement when withdrawal is possible under applicable law or regulation, if any.

QC 10.23 indicates that the firm should require the following policies and procedures related to maintaining independence:

- a. Engagement partners should provide the firm with pertinent information about engagements to enable the firm to evaluate the overall effect on independence requirements, if any. Pertinent information includes the scope of services to be provided to the client.
- b. Personnel should promptly notify the firm about relationships and situations that create an independence threat so that appropriate action can be taken. (The authors believe such notification should generally be made to the quality control director or other designated individual who has the responsibility to oversee the independence aspect of the firm's quality control system.)

- c. Accumulate and communicate relevant information to appropriate personnel so that—
 - (1) The firm and its personnel can determine whether they satisfy independence requirements.
 - (2) The firm can take appropriate action to address identified threats to independence that are not at an acceptable level.
 - (3) The firm can maintain current independence information.

Independence Representations. QC 10.25 indicates that the firm should, at least annually, obtain confirmation of compliance with its policies and procedures on independence from all firm personnel required to be independent. The representations should indicate whether the employee is complying with all of the requirements of the *Independence Rule* and its related interpretations, as well as the rules of state boards of accountancy and applicable regulatory agencies.

Independence Breaches. QC 10.24 requires that firms establish policies and procedures to attain reasonable assurance that the firm is notified of breaches of independence and takes appropriate actions to resolve such breaches. The firm's policies and procedures should include the following requirements:

- a. Personnel should promptly notify the firm of independence breaches once they become aware that a breach exists.
- b. The firm should promptly communicate identified breaches of its ethical requirements policies and procedures to—
 - (1) The engagement partner, who (along with the firm) needs to address the breach.
 - (2) Other relevant personnel in the firm (and when appropriate, the network) and those subject to the independence requirements who need to take appropriate action.
- c. The engagement partner (and other relevant personnel, including the network, when appropriate) should promptly communicate to the firm the actions taken to resolve the matter so that the firm can determine whether it should take further action.

The identification of an independence breach is a serious matter that the firm should promptly address. To ensure that personnel within the firm appropriately respond to the identification of an independence breach, the firm might consider providing additional independence-related education that reinforces identifying independence breach situations to personnel who are required to be independent. (The Uniform Accountancy Act already requires regular and recurring ethics education in conjunction with continuing professional education requirements.)

Breach of an Independence Interpretation. The *Breach of an Independence Interpretation* (ET 1.298.010) provides guidance to members for evaluating and addressing the consequences of an independence interpretation breach so the firm can determine whether consequences of the breach can be satisfactorily addressed and the attest engagement retained. ET 1.298.010.02 indicates that in order for the firm to rely on the provisions of the *Breach of an Independence Interpretation*, the firm must be in compliance with the requirements of QC 10 to have policies and procedures in place that provide reasonable assurance that the firm maintains independence.

The *Breach of an Independence Interpretation* provides specific steps that should be taken when a breach of an independence interpretation has occurred—

- a. Communicate the breach to the appropriate individual in the firm, consistent with QC policies and procedures.
- b. Report the breach to those in the firm who need to take appropriate action.
- c. Evaluate the significance of the breach.
- d. Ensure that the breach has been satisfactorily addressed and appropriate action has been taken. Certain breaches cannot be satisfactorily addressed and it may be necessary to terminate the attest engagement.

- e. Communicate with those charged with governance at the attest client.
- f. Document the breach and the actions taken by the firm.

Those steps are discussed further in this section.

Rotation of Personnel. Certain regulatory agencies or other authorities may require rotation of audit or attestation personnel after a specified period. For example, the PCAOB requires periodic rotation of engagement partners. QC 10.26 requires the firm's policies and procedures to address any requirements for rotation of personnel, if applicable.

Engagement Partner Consideration of Independence

The engagement partner generally considers relevant information about client engagements and evaluates the overall effect, if any, on independence requirements as part of the engagement acceptance and continuance decision. Making the decision about accepting and continuing client relationships and specific engagements is covered in Lesson 2.

To ensure that personnel consider independence on each engagement, many firms include in their work programs and checklists a step that asks the engagement team whether any independence problems exist and, if so, what steps need to be taken on the engagement. (PPC engagement work programs and checklists include procedures to ensure compliance with this requirement.)

Audit Requirements. In addition to complying with relevant ethical requirements in general, the audit engagement partner has specific independence requirements to consider. AU-C 220.13 indicates that the engagement partner should form a conclusion about compliance with independence requirements that apply to the audit engagement. In meeting this requirement, the engagement partner should:

- a. Obtain information from the firm to identify and evaluate circumstances and relationships that create threats to independence. This includes obtaining information from network firms, when the firm is associated with a network.
- b. Evaluate any identified breach of the firm's independence policies and procedures to determine whether the situation creates a threat to independence.
- c. Take appropriate action to eliminate any identified threats or to reduce them to an acceptable level by applying safeguards. An engagement partner's inability to resolve the matter may indicate that an independence breach has occurred and should be promptly communicated to an appropriate individual and the firm, so that appropriate action may be taken. Withdraw from the audit engagement, if considered appropriate, when withdrawal is permissible.

AU-C 220.25 specifies that the auditor should include in the audit documentation the conclusions made on compliance with independence requirements that apply to the engagement and any relevant discussions with the firm that support those conclusions.

AU-C 220.A5 further explains that when a threat to independence cannot be eliminated or reduced to an acceptable level for an audit engagement, the engagement partner reports to the relevant individual(s) in the firm to determine appropriate action. Appropriate action may include eliminating the activity or interest that created the threat, or withdrawing from the audit engagement, where withdrawal is possible under applicable law or regulation, if any.

Complying with Independence Requirements

Designating a Partner to be Responsible. For a firm that performs attest services, maintaining independence is of the utmost importance. As a result, the firm should assign to the quality control director or other designated partner the responsibility for overseeing compliance with ethical requirements (referred to in this course as the *ethics partner*). (The *Breach of an Independence Interpretation* uses the term *responsible individual* as the person in the firm who is responsible for the policies and procedures relating to independence. Use of the term *ethics partner* in this course denotes the same person as *responsible individual*.) The ethics partner needs to have a current and detailed working knowledge of the guidance contained in the Preface and Part 1 of the *Code of Professional*

Conduct. In addition, the ethics partner oversees the administration of all firm independence-related matters, which often includes—

- Answering questions relating to relevant ethical requirement issues.
- Maintaining the current client list.
- Informing personnel of independence requirements.
- Obtaining periodic (at least annual) independence representations from personnel and following up on potential threats to independence.
- Accumulating and communicating information within the firm once a potential independence threat or breach has been identified.
- Assisting in evaluating threats and resolving breaches, including determining whether outside consultation may be needed.

Maintaining the Current Client List. Before employees can evaluate whether they are independent with respect to attest clients, the firm needs to develop and maintain a list of clients for which financial interests or business relationships are prohibited. Personnel usually need to review a current list of the firm's attest clients in order to make an informed decision about whether a possible independence violation exists. While personnel in small firms may be familiar with all the firm's clients, that situation generally begins to change as the firm grows. Additionally, some firms may choose to maintain a list of all clients for firm personnel to review in the event that a current tax client becomes a review client, for example. Preparation of client lists can be relatively easy through the use of time and billing software used by many firms.

To facilitate periodic review of the client list, it is helpful for the client list to be readily accessible to all professional employees, perhaps by maintaining it electronically on the firm's network, as well as posting the list in the firm library, copy room, break room, or other location where employees can easily and regularly review the list of firm clients. New professional staff need to be given a copy of the current client list and be instructed about the firm's procedures for maintaining client independence.

Informing Employees of Changes to Client List. Since a firm is required to establish procedures designed to provide it with reasonable assurance that the firm and its personnel maintain independence where required, a firm needs to provide updated client lists to professional personnel frequently enough to achieve that reasonable assurance. Employees need to be informed on a timely basis of changes (both additions and deletions) to the firm's client list. The authors recommend that the list be updated often so that independence evaluations are always based on the most current firm client information. A firm can replace posted client lists with updated lists as needed or regularly (for example, once a quarter) to keep such information current. Along with updating the client list, some firms inform their personnel that there has been a change in the firm's clients by sending out email notifications each time such a change occurs.

Informing Employees of Independence Requirements. While most professional employees are familiar with the overarching requirement to be independent under the Code's *Independence Rule*, they probably are not as familiar with the many independence interpretations. Also, employees may not be aware of special or unique independence requirements of various regulatory bodies to which the firm may be subject, including state CPA societies and boards of accountancy, state statutes, and other regulatory bodies. It is critical for the firm to take deliberate measures to ensure that employees are fully aware of both the independence requirements and the clients for which financial or business relationships are prohibited.

Once the client list is available, the firm can communicate the independence and other relevant ethical requirements (including rules of applicable regulatory bodies), as well as prohibited client relationships. To communicate this information, a current copy of the requirements and rules affecting the firm may be made available electronically on the firm's network, as well as in the firm's library or any other location accessible to employees.

Some firms may want to know in advance of proposing on an engagement whether independence issues might exist at the professional staff level. At the time these firms are asked to propose on a large audit engagement, for example,

the firm can send notification to professional employees and ask them to communicate back any personal independence conflicts with the prospective client.

An alternative to the firm communicating prohibited client relationships to personnel might be considered for large and multi-office firms. In such firms, it may be more efficient for each professional employee to periodically (annually, at a minimum) provide a list of all personal investments; interests in partnerships and joint ventures; loans receivable and payable; and family relationships with owners, directors, or officers of any company to the ethics partner. Such a process places the responsibility of matching investments and relationships on the professional employee's list to the client list in the hands of the ethics partner. Additionally, accumulating such information from the professional staff allows the firm to potentially know before an attest engagement is accepted that such a relationship with the client will create a threat to independence.

Finally, to reinforce the awareness and importance of maintaining independence, firms may also consider establishing regular periodic communications about professional responsibilities to personnel as a way to assist in keeping independence in the forefront of the minds of engagement teams.

Obtaining Written Representations of Independence. As previously mentioned, QC 10.25 requires the firm to obtain confirmation of independence annually, *at a minimum*, from personnel who are required to be independent. Many firms accomplish this by requiring such individuals to review the firm's independence requirements and sign an independence representation form at time of employment and annually thereafter. The firm may attach a copy of its independence requirements to the independence representation form to better ensure the requirements are reviewed. (The authors believe that any individual who works on an engagement for which independence is required must be independent and should sign an annual independence representation, including a paraprofessional who may not yet have earned a degree and is not a CPA. Independence should be assured for any individual working on an attest engagement in a staff capacity.)

QC 10.A10 explains that personnel may provide their confirmation of independence in either written or electronic form. The guidance also indicates obtaining such confirmations and taking appropriate action on information indicating noncompliance with independence requirements demonstrates the importance the firm places on independence and keeps the issue visible to its personnel.

Evaluating Independence Representations. Once independence representations are obtained, it is important for the firm to take appropriate action to address any information indicating potential noncompliance with independence requirements. The ethics partner is often responsible for accumulating and evaluating employee responses to identified independence breaches and potential threats to independence. If threats or breaches are identified based on the evaluation, the ethics partner should then accumulate and communicate the relevant information to the appropriate personnel in the firm.

Identifying Independence Threats and Breaches. An important aspect of establishing quality control policies and procedures to ensure that the firm and its personnel comply with ethical requirements includes prompt notification of potential threats and breaches once identified. Personnel should promptly notify the firm (ordinarily the ethics partner) of any circumstance or relationship that appears to create a threat to, or breach of, the firm's independence. If a staff person is unsure whether a threat exists, they should not hesitate to discuss the situation with the engagement partner. However, once it is determined that a threat exists, the authors suggest the ethics partner be notified and the threat be documented and formalized for further consideration. If the engagement partner believes the identified situation represents a breach, communication should promptly be made to the ethics partner, who then reports the breach to those in the firm who need to take appropriate action. The breach should also be reported to relevant network firms.

Accumulating and Communicating Information about Identified Threats. When a threat to independence is identified, the ethics partner should begin accumulating pertinent information for further analysis of the circumstance. As much information as possible needs to be obtained so the firm can make an informed and appropriate evaluation about whether or not the independence threat can be mitigated. The information collected should be communicated to the engagement partner, firm management, and other relevant firm personnel as appropriate so the threat can be evaluated. This process should be documented. One method for doing so is by using the practice aid provided in *PPC's Guide to Quality Control*.

Evaluating Threats to Independence. To evaluate circumstances and relationships that create threats to independence, firm management and the ethics partner need to be familiar with the authoritative guidance relating to independence. Information about the authoritative guidance relating to independence was provided earlier in this lesson.

Taking appropriate action to resolve independence threats will depend on the type of independence threat identified. The *Conceptual Framework for Independence* identifies seven different types of threats to independence. Based on the unique facts and circumstances, the firm should evaluate the type of threat and determine whether or not the threat can be mitigated, or if it represents an independence breach requiring corrective action.

One example of a threat that the firm could mitigate would be a familiarity threat identified because an audit engagement team member has a close friend who accepts a key position with the attest client. (The term *key position* has a specific meaning as defined by the Code at ET 0.400.27.) In that situation, the firm could remove the member creating the familiarity threat from the attest engagement team. Once the team member is moved, the threat to independence has been mitigated.

As another example of a threat to independence, a member submits a proposal for a new client who is requesting quarterly reviews and a year-end audit, the fees from which would be significant to the firm. The significance of the fees collected from this potential client might diminish the member's ability to be objective and maintain independence while performing the attest services, creating a self-interest threat. Possible safeguards in this situation include subjecting the assignment of engagement personnel for this client to the approval of another partner or manager, or subjecting the audit engagement to a post-issuance review.

Taking Appropriate Action When Independence Breaches Are Identified. To ensure that corrective action is taken once an independence breach is discovered, the firm needs to carefully determine the appropriate course of action. To remedy an independence breach, a firm considers whether the situation that caused the breach can be undone. Breaches to independence are typically not as simple as mitigating an identified threat. To actually resolve the independence breach, often the firm has no choice but to withdraw from the engagement. In some cases, especially if the breach was accidental, it may be possible to reverse the situation that created the breach, such as terminating any financial interest in the client. However, if the financial interest has existed for some period of time, often the firm will need to withdraw from the engagement.

Handling an Independence Breach under the Code. As previously mentioned, the *Breach of an Independence Interpretation* (ET 1.298.010) provides steps and actions that should be taken when a member or member firm becomes aware that a breach of an independence interpretation has occurred.

Accordingly, the authors recommend that formal procedures be established so that once an independence breach is identified, the engagement partner, the ethics partner, and others in firm management as appropriate, determine if or how the breach can be corrected and what type of continuing relationship the firm may have with the client. To resolve the matter, the ethics partner and the firm should evaluate the breach's significance and its effect on the attest engagement team's integrity, objectivity, and professional skepticism, and the ability to issue an attest report. The significance of the breach depends on factors such as—

- Its nature and duration.
- The quantity and nature of any previous breaches with respect to the current attest engagement.
- Whether a member of the attest engagement team knew about the interest or relationship that caused the breach.
- Whether the individual who caused the breach is on the attest engagement team or is another individual for whom independence is required.
- If the breach relates to someone on the attest engagement team, that person's role on the team.
- If the breach was caused by providing a professional service, the effect of the service, if any, on the accounting records or the attest client's financial statements.

- Whether the engagement partner knew about the breach but did not ensure that it was promptly communicated to the ethics partner.
- Whether the breach involved only an affiliate of a financial statement attest client and, if so, the nature of the affiliate relationship.
- The extent of self-interest, advocacy, undue influence, or other threats the breach created.

After considering the significance of the breach, the ethics partner should determine whether satisfactory action can be taken that is appropriate in the circumstances. The ethics partner should exercise professional judgment in making the determination, including the consideration of whether a reasonable and informed third party, weighing the significance of the breach, the action to be taken, and all the specific facts and circumstances available at the time, would likely conclude that independence was impaired because the attest engagement team's integrity, objectivity, and professional skepticism were compromised (such a situation results in a breach that cannot be remedied, as discussed below).

If necessary, the ethics partner needs to consult authoritative literature in resolving the matter. The resolution may range from taking appropriate actions to resolve the problem, such as—

- Removing the relevant individual from the attest engagement team.
- Maintaining the client relationship but limiting the services and the report that can be rendered (for example, by withdrawing from the attest engagement, but continuing the tax and write-up work).
- Using different personnel to perform an additional review of the affected attest work or reperform the work to the extent necessary.
- Suggesting that the attest client engage a different firm to review or reperform the affected attest work to the extent necessary.
- Terminating the financial interest that caused the breach.

Whatever the resolution, once the appropriate actions are taken, the engagement partner should formally confirm to firm management and the ethics partner that such actions have taken place.

Breach of an Independence Interpretation describes two situations in which there is no action that can be taken to satisfactorily address the consequences of the breach—

- A firm partner or professional employee breaches an independence interpretation, and the attest engagement team's integrity, objectivity, and professional skepticism are compromised.
- The lead attest engagement partner or an individual in a position to influence the attest engagement either (a) committed the breach or (b) knows of a breach and does not ensure that it is promptly communicated to the ethics partner.

Communicating With Those Charged With Governance at the Attest Client. If it is determined that no action can be taken to satisfactorily address the consequences of the breach, the ethics partner should inform those charged with governance as soon as practicable and take steps to terminate the attest engagement. (If termination is not permitted by law or regulation, the ethics partner should comply with any reporting or disclosure requirements.)

If it is determined that action can be taken to satisfactorily address the consequences of the breach, the ethics partner should discuss the breach and the action taken (or proposed to be taken) with those charged with governance as soon as practicable. The matters to be discussed should include the following:

- The breach's significance, including its nature and duration.
- How it occurred and was identified.
- The action (or proposed action) and the rationale for how it will satisfactorily address the breach's consequences and enable the firm to issue the attest report.

- The conclusion (including the rationale for the conclusion) that, in the ethics partner's professional judgment, the integrity, objectivity, and professional skepticism of the attest engagement team have not been compromised.
- Steps the ethics partner has taken (or proposes to take) to reduce or avoid the risk of further breaches.

The ethics partner should communicate in writing to those charged with governance all of the matters discussed and obtain agreement from those charged with governance that satisfactory action has been (or can be) taken. If agreement is not obtained, the ethics partner should take steps to terminate the attest engagement, where permitted by law or regulation.

Breach Occurred Prior to Previously Issued Report. If the breach occurred prior to issuance of the previous attest report, the ethics partner should—

- Follow the *Breach of an Independence Interpretation* guidance in evaluating the significance of the breach and its effect on the attest engagement team's objectivity, integrity, and professional skepticism, and the attest engagement team's ability to issue an attest report in the current period.
- Consider the effect of the breach, if any, on the attest engagement team's integrity, objectivity, and professional skepticism in relation to any previously issued attest reports, and the possibility of withdrawing such reports in accordance with professional standards, and discuss the matter with those charged with governance.

Documentation. *Breach of an Independence Interpretation* includes a list of items that should be documented beginning at the time the breach is identified until it is satisfactorily concluded. Those items include the breach, the action taken, key decisions made, all matters discussed with those charged with governance, and any discussions with a professional body, relevant regulator, or oversight authority. When the firm continues with the attest engagement, additional documentation includes the conclusion that the attest engagement team's integrity, objectivity, and professional skepticism have not been compromised and the rationale for why the action taken satisfactorily addressed the consequences of the breach.

Communicating the Resolution to Engagement Staff. The authors also recommend that firms communicate the resolution of the independence matter to the affected engagement staff. Such a procedure not only promotes transparency and may address the communication to appropriate personnel required by QC 10.24, but it also provides an excellent training opportunity for staff to see how appropriate action is taken when independence matters are discovered.

Determining How the QC System Failed

The firm may occasionally receive notice that a breach of its independence policies and procedures has occurred. In addition to addressing the situation as has been described within this section, the authors also recommend that the firm put guidelines in place to analyze and evaluate "what went wrong" that allowed the independence breach to occur. When a firm discovers that personnel have not followed the firm's policies and procedures for relevant ethical requirements, the firm needs to investigate the matter to determine why the QC system did not work and what changes are necessary to obtain reasonable assurance that the QC system will work more effectively in the future. Perhaps the firm did not include a comprehensive set of procedures to ensure compliance with the policy. Perhaps the firm did not provide adequate training to its employees, particularly new staff, to ensure that personnel understood the procedures they were expected to follow.

It is not unusual for a firm that has recently begun providing attest services to experience a period of trial and error with its QC system before the firm attains the right set of policies and procedures. Additionally, a firm may have setbacks before it finds the best method to ensure compliance with its QC system. The material in this course (as well as in *PPC's Guide to Quality Control*) has been developed to help firms to both put an effective QC system in place from the outset and maintain an effective 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.

8. Which of the following member CPAs' independence is impaired under the familiarity threat?
 - a. Ross prepares the source documents used to generate his attest client's financial statements.
 - b. Julie's husband, Russ, holds a key position with her potential attest client.
 - c. Ben promotes his attest client's securities as part of their initial public offering.
 - d. Emma is the CFO of a nonprofit organization that wants to engage her firm to perform its audit.
9. Which of the following independence requirements must be met before AICPA members perform nonattest services for attest clients?
 - a. The member should assume management responsibilities for the attest client.
 - b. The member must agree to perform all functions related to the nonattest services provided.
 - c. The member should establish and document the understanding about such services with the client.
 - d. The member should disregard independence requirements from other regulatory bodies.
10. Assuming all other safeguards are met and no interpretations state otherwise, a member can perform nonattest services for an attest client and retain independence under what circumstances?
 - a. The member agrees to oversee all nonattest services.
 - b. The member agrees to accept responsibility for the results of the services.
 - c. Client management agrees to evaluate the adequacy and results of the services.
 - d. The member documents the understanding in writing as of the financial statement date.
11. Doing which of the following for an attest client will always impair a member's independence?
 - a. Providing management with advice or research materials.
 - b. Recommending improvements to business risk control processes.
 - c. Installing an off-the-shelf accounting package.
 - d. Authorizing, executing, or consummating transactions.
12. Which of the following statements best describes one of other independence requirements in addition to those found in the Code?
 - a. As of 2022, all state boards of accountancy and CPA societies have adopted the AICPA's ethics rules.
 - b. If *Government Auditing Standards* (the Yellow Book) does not prohibit nonaudit engagements, independence is not impaired.
 - c. Practitioners who perform engagements for certain government agencies, like HUD, may have to comply with more restrictive rules.
 - d. The Yellow Book requires auditors to be independent only during the time period they are performing a Yellow Book audit.

13. A firm's quality control policies and procedures related to independence breaches should include which of the following?
- a. That independence breaches are addressed by the time the related attest engagement is complete.
 - b. That personnel identify the client of independence breaches as soon as they become aware of them.
 - c. That the firm provides independence-related education to all firm members.
 - d. That the engagement partner promptly communicates actions taken to resolve breaches to the firm.
14. Which of the following statements best describes an issue related to maintaining the current client list?
- a. Firms should release a printed copy of the list at least once per year.
 - b. Maintaining a list is unneeded as firm members will know all the firm's clients.
 - c. The list should be updated on a timely basis for both additions and deletions.
 - d. Preparing a client list is often a difficult and complex process that requires the help of many employees.
15. Under what circumstances is it most likely that a firm can reverse a breach of independence?
- a. The breach was accidental.
 - b. The breach involves a long-standing financial interest.
 - c. The firm has no formal procedures for dealing with breaches.
 - d. The threat can be mitigated.

SELF STUDY ANSWERS

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

8. Which of the following member CPAs' independence is impaired under the familiarity threat? **(Page 164)**
- a. Ross prepares the source documents used to generate his attest client's financial statements. [This answer is incorrect. Per ET 1.210.010.12–.18, this is an example of the self-review threat. In addition, this is an example of a self-review threat so significant that no safeguards can eliminate the threat or reduce it to an acceptable level.]
 - b. **Julie's husband, Russ, holds a key position with her potential attest client. [This answer is correct. The *Conceptual Framework for Independence* identifies the same broad categories of threats and safeguards as the *Conceptual Framework for Members in Public Practice*; however, the *Conceptual Framework for Independence* provides different examples in relation to independence. As outlined in ET 1.210.010.12–.18, the familiarity threat relates to the member having a long or close relationship with the client. One example of this is a member of the attest engagement team (like Julie) having an immediate family member (like Russ), close relative, or close friend in a key position at the attest client.]**
 - c. Ben promotes his attest client's securities as part of their initial public offering. [This answer is incorrect. According to ET 1.210.010.12–.18, this is an example of the advocacy threat as that threat relates to independence.]
 - d. Emma is the CFO of a nonprofit organization that wants to engage her firm to perform its audit. [This answer is incorrect. This is an example of the management participation threat, as that threat is described in ET 1.210.010.12–.18.]
9. Which of the following independence requirements must be met before AICPA members perform nonattest services for attest clients? **(Page 165)**
- a. The member should assume management responsibilities for the attest client. [This answer is incorrect. According to the *Nonattest Services* Interpretation, the member should *not* assume management responsibilities for the attest client. If the member does assume such responsibilities, independence is impaired.]
 - b. The member must agree to perform all functions related to the nonattest services provided. [This answer is incorrect. As outlined in the *Nonattest Services* Interpretation, the attest client must agree to perform certain specific functions in connection with the nonattest services or independence will be impaired.]
 - c. **The member should establish and document the understanding about such services with the client. [This answer is correct. The *Nonattest Services* Interpretation sets requirements for remaining independent of an attest client, as well as for completing the engagement when performing nonattest services for the client. Before AICPA members perform nonattest services, they should determine and document that the requirements of this interpretation have been met. One such requirement is that the member should establish and document in writing the understanding with the attest client regarding the nonattest services.]**
 - d. The member should disregard independence requirements from other regulatory bodies. [This answer is incorrect. The *Nonattest Services* Interpretation states that failure to meet more restrictive independence requirements of regulatory bodies (e.g., the SEC or GAO) to which the member is subject constitutes a violation of this interpretation.]

10. Assuming all other safeguards are met and no interpretations state otherwise, a member can perform nonattest services for an attest client and retain independence under what circumstances? **(Page 166)**
- a. The member agrees to oversee all nonattest services. [This answer is incorrect. The member's independence will not be impaired if, among other things, the member determines that the attest client and its management agree to oversee the services by designating an individual, preferably within senior management, who possesses suitable skill, knowledge, or experience. The member should assess the designated individual and be satisfied that the individual sufficiently understands the services to be performed to oversee them. However, the designated individual does not have to possess the expertise necessary to perform the services.]
 - b. The member agrees to accept responsibility for the results of the services. [This answer is incorrect. Among other things, the attest client and its management must agree to accept responsibility for the results of the services. If not, the member's independence will be impaired.]
 - c. **Client management agrees to evaluate the adequacy and results of the services. [This answer is correct. Provided that an interpretation does not state otherwise, performing nonattest services for an attest client will not impair a member's independence if all of the appropriate safeguards are met. One such safeguard is that the member determines that the attest client and its management agree to evaluate the adequacy and results of the services performed.]**
 - d. The member documents the understanding in writing as of the financial statement date. [This answer is incorrect. *Before performing nonattest services*, the member must establish and document in writing an understanding with the attest client about the objectives and any limitations of the nonattest services engagement, the services to be performed, the attest client's acceptance of its responsibilities, and the member's responsibilities.]
11. Doing which of the following for an attest client will always impair a member's independence? **(Page 167)**
- a. Providing management with advice or research materials. [This answer is incorrect. According to ET 1.295.105, providing management with advice, research materials, and recommendations to help it carry out managerial functions and make decisions are advisory services that will *not* impair independence.]
 - b. Recommending improvements to business risk control processes. [This answer is incorrect. Per ET 1.295.125, business risk consulting services including recommending improvements to the business risk control processes and assisting in implementing the improvements do *not* impair independence.]
 - c. Installing an off-the-shelf accounting package. [This answer is incorrect. As discussed in ET 1.295.145, installing or integrating an attest client's financial information system, that was not designed or developed by the member (e.g., an off-the-shelf accounting package), will *not* impair the member's independence.]
 - d. **Authorizing, executing, or consummating transactions. [This answer is correct. Certain activities performed as part of a nonattest service are considered to be management responsibilities and, therefore, impair independence regardless of whether the member complies with the other requirements in the *Nonattest Services* Interpretation. Examples of such activities include authorizing, executing, or consummating transactions, or otherwise exercising authority on behalf of the client, or having the authority to do so.]**
12. Which of the following statements best describes one of other independence requirements in addition to those found in the Code? **(Page 182)**
- a. As of 2022, all state boards of accountancy and CPA societies have adopted the AICPA's ethics rules. [This answer is incorrect. Most state boards of accountancy and CPA societies adopt the ethics rules of the AICPA as the same rules that govern practices within their states. However, practitioners need to know whether their state has particular rules that are different from those of the AICPA.]

- b. If *Government Auditing Standards* (the Yellow Book) does not prohibit nonaudit engagements, independence is not impaired. [This answer is incorrect. The Yellow Book identifies specific nonaudit services that always impair independence and that auditors are prohibited from providing to audited entities. If a nonaudit service is not specifically prohibited, however, the auditor is required to assess its impact on independence using the Yellow Book's conceptual framework.]
 - c. **Practitioners who perform engagements for certain government agencies, like HUD, may have to comply with more restrictive rules.** [This answer is correct. Practitioners performing engagements for certain government agencies must comply with independence rules that, in some instances, are more restrictive than the AICPA rules. For example, a firm that performs bookkeeping services for a HUD project or an employee benefit plan may not be considered independent of the project or plan by HUD or the Department of Labor, respectively, even though the firm could be independent under the AICPA requirements.]
 - d. The Yellow Book requires auditors to be independent only during the time period they are performing a Yellow Book audit. [This answer is incorrect. According to Paragraphs 3.20 and 3.23 of the Yellow Book, the auditor should be independent from an audited entity during (1) any period of time that falls within the period covered by the financial statements or subject matter of the engagement and (2) the entire period of the professional engagement, which begins when the auditor signs the engagement letter or actually begins to perform the engagement, whichever is earlier. The period of time the professional engagement does not necessarily end when the report is issued. It spans the duration of the professional relationship (which, for recurring audits, could cover several periods) and ends with notification by either party of the termination of the relationship or by issuance of a report, whichever is later.]
13. A firm's quality control policies and procedures related to independence breaches should include which of the following? **(Page 185)**
- a. That independence breaches are addressed by the time the related attest engagement is complete. [This answer is incorrect. The identification of an independence breach is a serious matter that the firm should promptly address. Waiting until the engagement is complete would not be a best practice.]
 - b. That personnel identify the client of independence breaches as soon as they become aware of them. [This answer is incorrect. The firm's policies and procedures should have personnel promptly notify the *firm* (not the client) of independence breaches once they become aware that a breach exists.]
 - c. That the firm provides independence-related education to all firm members. [This answer is incorrect. To ensure that personnel within the firm appropriately respond to the identification of an independence breach, the firm might consider providing additional independence-related education that reinforces identifying independence breach situations to personnel who are required to be independent. However, this is not a requirement that needs to be specifically outlined in the firm's policies and procedures.]
 - d. **That the engagement partner promptly communicates actions taken to resolve breaches to the firm.** [This answer is correct. QC 10.24 requires that firms establish policies and procedures to attain reasonable assurance that the firm is notified of breaches of independence and takes appropriate actions to resolve such breaches. The firm's policies and procedures should include the requirement that the engagement partner (and other relevant personnel, including the network, when appropriate) should promptly communicate to the firm the actions taken to resolve the matter so that the firm can determine whether it should take further action.]

14. Which of the following statements best describes an issue related to maintaining the current client list? **(Page 187)**

- a. Firms should release a printed copy of the list at least once per year. [This answer is incorrect. To facilitate periodic review of the client list, it is helpful for the client list to be readily accessible to all professional employees, perhaps by maintaining it electronically on the firm's network, as well as posting the list in the firm library, copy room, break room, or other location where employees can easily and regularly review the list of firm clients. New professional staff need to be given a copy of the current client list and be instructed about the firm's procedures for maintaining client independence.]
- b. Maintaining a list is unneeded as firm members will know all the firm's clients. [This answer is incorrect. While personnel in small firms may be familiar with all the firm's clients, that situation generally begins to change as the firm grows, so a client list is needed.]
- c. **The list should be updated on a timely basis for both additions and deletions. [This answer is correct. Since a firm is required to establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel maintain independence where required, a firm needs to provide updated client lists to professional personnel frequently enough to achieve that reasonable assurance. Employees need to be informed on a timely basis of changes (both additions and deletions) to the firm's client list. This course recommends that the list be updated often so that independence evaluations are always based on the most current firm client information, perhaps once a quarter.]**
- d. Preparing a client list is often a difficult and complex process that requires the help of many employees. [This answer is incorrect. Preparation of client lists can be relatively easy through the use of time and billing software used by many firms.]

15. Under what circumstances is it most likely that a firm can reverse a breach of independence? **(Page 189)**

- a. **The breach was accidental. [This answer is correct. In some cases, especially if the breach was accidental, it may be possible to reverse the situation that created the breach, such as terminating any financial interest in the client. ET 1.298.010 provides steps and actions that should be taken when a member or member firm becomes aware that a breach of an independence interpretation has occurred.]**
- b. The breach involves a long-standing financial interest. [This answer is incorrect. If a financial interest in a client has existed for some period of time, often the firm will need to withdraw from the engagement as it will not be easy to reverse the breach.]
- c. The firm has no formal procedures for dealing with breaches. [This answer is incorrect. This course recommends that formal procedures be established so that once an independence breach is identified, the engagement partner, the ethics partner, and other in firm management as appropriate, determine if or how the breach can be corrected and what type of continuing relationship the firm may have with the client. Logically, it will be easier for the firm to reverse such a breach if it has such procedures in place when one occurs.]
- d. The threat can be mitigated. [This answer is incorrect. To remedy an independence breach, a firm considers whether the situation that caused the breach can be undone. Breaches to independence are typically not as simple as mitigating an identified threat. To actually resolve the independence breach, often the firm has no choice but to withdraw from the engagement.]

QUALITY CONTROL POLICIES AND PROCEDURES

For some of the elements of quality control, professional standards 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 authoritative literature. The quality control requirements of the relevant ethical requirements element of QC 10, as well as the relevant requirements of the Code, were discussed earlier in this lesson. *PPC's Guide to Quality Control* includes a questionnaire designed as an aid for firms to more easily determine whether independence requirements of the Code are being met, if practitioners choose to use it.

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 tool 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 authors recommend that the illustrative examples found in the AICPA Practice Aid for designing the relevant ethical requirements element of the quality control system be considered.

Exhibit 1-9 is based on a section from the 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 relevant ethical requirements quality control system. Example policies are in bold type, example procedures are in regular type, and potential suggested descriptions are in italics.

Exhibit 1-9

AICPA Illustrative Quality Control Policies and Procedures Related to Relevant Ethical Requirements

1. **The firm and its personnel comply with relevant ethical requirements. (See paragraph .21 of QC section 10.)**
 - A partner [*name*] is responsible for staying informed on relevant ethical requirements; providing guidance; answering questions; monitoring compliance; and resolving matters with respect to independence, integrity, and objectivity.
 - All personnel have access to current guidance materials regarding the applicable independence, integrity, and objectivity requirements through [*identify how, for example through subscription service or via the AICPA's website*].
 - Documentation of the resolution of ethical matters is required when consultation, including of professional literature, has occurred.
 - When providing nonattest services (such as bookkeeping, financial statement preparation, and tax services) to clients for whom the firm also performs an audit, review, compilation, or attestation engagement, the firm, its personnel, and when applicable, others subject to independence requirements, meet all the requirements of the *Nonattest Services* subtopic of the AICPA *Code of Professional Conduct* (AICPA, *Professional Standards*, ET sec. 1.295) and the requirements of other regulators as applicable.
 - The firm has established and follows a process for identifying all services performed for each client and evaluating, at the attest engagement level, whether nonattest services are provided that might impair independence. [*Describe the process.*]
 - The firm maintains a current list of—
 - all entities with which firm personnel are prohibited from having a financial or business relationship and

- all activities that the firm is prohibited from performing, as defined in the firm's independence policies.
 - The firm has clear and concise written independence guidance covering relationships and activities that impair independence, including but not limited to investments, loans, brokerage accounts, business relationships, employment relationships, and fee arrangements.
- 2. The firm communicates its independence requirements to firm personnel and, when applicable, others subject to them. (See paragraph .22a of QC section 10.)**
- The firm provides its personnel with a list of all entities with which firm personnel are prohibited from having a business relationship and informs them on a timely basis as to any changes in the firm's clients to which independence policies apply.
 - The firm reminds personnel of independence considerations for regulated industries.
 - The firm provides reminders of professional responsibilities to personnel, such as avoiding behavior that might be perceived as impairing their independence or objectivity, as necessary and at least annually.
 - The firm informs its personnel of the types of financial or other relationships that may impair independence and that may be prohibited.
 - The firm requires professional personnel to take independence and ethics training [*specify period, such as annually*]. Such training covers the firm's independence and ethics policies and the independence and ethics requirements of all applicable regulators.
- 3. The firm evaluates threats to independence and objectivity, including the familiarity threat that may be created by using the same senior personnel on an audit or attest engagement over a long period of time. The firm takes appropriate action to eliminate them or reduce them to an acceptable level by applying safeguards. (See paragraph .22b of QC section 10.)**
- Approval of the assignment of engagement personnel by another partner or manager is required for each audit or attestation examination.
 - New personnel assigned to the engagement are encouraged to bring a fresh perspective.
 - A partner who is not otherwise associated with the engagement reviews the engagement.
 - The firm (the managing partner, QC partner, and others as appropriate) considers the significance of each client to the firm. In broad terms, the significance of a client to a firm refers to relationships that could diminish a practitioner's objectivity and independence in performing attest services. In determining the significance of a client, the firm considers (a) the amount of time the partner devotes to the engagement, (b) the effect on the partner's stature within the firm as a result of their service to the client, (c) the manner in which the partner is compensated, and (d) the effect that losing the client would have on the partner and the firm.
 - When a relationship or circumstance that may create threats to compliance with the rules is identified, the firm performs procedures to evaluate threats and apply safeguards [*using the Conceptual Framework Toolkit for Members in Public Practice*].
 - The engagement partner [*considers or provides the firm with*] relevant information about client engagements, including the scope of services and any changes, such as new engagements or changes in the level of service, to enable [*the engagement partner or the firm*] to evaluate the overall impact, if any, on independence requirements. (See paragraph .23a of QC section 10.)
 - The firm requires personnel to promptly notify the firm of circumstances and relationships that create a threat to independence so that appropriate action can be taken. (See paragraph .23b of QC section 10.)
 - The firm compiles and communicates relevant information to appropriate personnel so that (a) the firm and its personnel can readily determine whether the firm and its personnel satisfy independence requirements; (b) the firm can maintain and update information relating to independence, and (c) the firm can take

appropriate action regarding identified threats to independence that are not at an acceptable level. (See paragraph .23c of QC section 10.)

- The firm requires personnel to consult with individuals outside the firm on independence, integrity, or objectivity concerns that research has not clearly resolved.
4. **Personnel notify the firm of breaches of independence requirements and the firm takes appropriate actions to resolve such situations. (See paragraph .24 of QC section 10.)**
- All professional personnel are required to notify *[specify who in the firm—for example, the managing partner of the office]* of any potential activities involving themselves, their spouses, or their dependents that might impair independence or violate ethics rules, including services provided to entities with which firm personnel are prohibited from having a business relationship. (See paragraph .24a of QC section 10.)
 - The firm has a process that protects professional personnel who report potential ethics or independence violations to the proper parties in compliance with firm policy.
 - The firm's policy and procedures manual sets forth the consequences for professional personnel who violate the firm's independence policies and procedures, including engaging in activities with entities with which firm personnel are prohibited from having a business relationship.
 - The firm determines the need for safeguards for engagements when the familiarity threat exists on an audit, review or attestation engagement.
 - The firm promptly communicates identified breaches of these policies and procedures, and the required corrective actions, to (a) the engagement partner who, with the firm, needs to address the breach and (b) other relevant personnel in the firm and those subject to the independence requirements who need to take appropriate action. (See paragraph .24b of QC section 10.)
 - The engagement partner and other relevant personnel confirm to the firm that the required corrective actions have been taken (See paragraph .24c of QC section 10.)
 - Appropriate personnel *[Identify]* are responsible for periodically *[identify time period]* reviewing unpaid fees from clients to ascertain whether any outstanding amounts may impair the firm's independence, and following up with the engagement partner.
5. **The firm does not accept or withdraws from the engagement if effective safeguards to reduce threats to independence to an acceptable level cannot be applied.**
- The firm consults internally, and with legal counsel and other parties if necessary, when the firm believes that effective safeguards to reduce threats to independence to an acceptable level cannot be applied.
 - The firm withdraws from the engagement when withdrawal is possible under applicable law or regulation, or does not accept the engagement, when effective safeguards to reduce threats to independence to an acceptable level cannot be applied.
6. **The firm obtains written confirmation, upon hire and at least annually thereafter, of compliance with its policies and procedures regarding independence from all personnel required to be independent by relevant requirements. (See paragraph .25 of QC section 10.)**
- Personnel provide written representations, upon hire and on an annual basis thereafter, that they have read the firm's independence, integrity, and objectivity policies, understand the applicability of those policies to their activities, and have complied with the requirements of those policies since their last representation. Personnel are required to review the most current list of all entities with which firm personnel are prohibited from having a business relationship prior to providing the written representation.
 - *[Specify name or position, for example: The firm's quality control partner]* is responsible for obtaining such written representations, reviewing independence compliance files for completeness, and resolving reported exceptions.

- On each engagement, the engagement partner signs a step in the engagement program attesting to compliance with independence requirements that apply to the engagement.
- 7. When another firm, or firm personnel in associated member firms, performs part of the engagement, the firm confirms the independence of the other firm and adherence to other relevant ethical requirements.**
- Written confirmations are obtained regarding the other firm's independence with respect to audit engagements and either written or oral confirmations are obtained for review or attestation engagements. Oral confirmations are documented.
 - The firm's policies and procedures manual or practice aids describe the form and content of independence representations, and frequency with which they are to be obtained.
 - As a member of a network, the firm—
 - meets all the relevant ethical requirements and
 - monitors its independence with respect to financial statement audits, reviews, and other attest engagements performed by other members of the network.
- 8. The firm rotates personnel for audit or attest engagements for which regulatory or other authorities require such rotation after a specified period. (See paragraph .26 of QC section 10.)**
- The quality control partner monitors regulatory requirements for financial institutions and other regulated entities and notifies partners of the need for rotation.
-

While the AICPA's illustrative policies and procedures provide a logical starting point for designing the relevant ethical requirements quality control system, the authors urge careful consideration of the firm's needs 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 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.

Peer Reviewers Evaluate Firm QC System Design. During the planning phase of a firm's peer review, the peer reviewer completes a questionnaire to evaluate the design of the firm's quality control policies and procedures. The questionnaire concentrates on the QC 10 requirements for each element of quality control, but also considers the related application guidance. Reviewers consider if a firm's documented quality control policies and procedures do not address the guidance in QC 10 because such a situation may indicate that the firm's system of quality control could be out of compliance with professional standards. Firms may access those questionnaires in the AICPA Peer Review Program Manual (PRPM); section 4600 of the PRPM presents the questionnaire for firms with two or more personnel and section 4500 of the PRPM presents the questionnaire for a sole practitioner with no personnel. The authors recommend that practitioners involved in designing and maintaining the firm's QC system read the 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 also available on the AICPA's Enhancing Audit Quality Initiative resources web page at [us.aicpa.org/InterestAreas/PrivateCompaniesPracticeSection/QualityServicesDelivery/KeepingUp/invigorate-the-focus](https://www.aicpa.org/InterestAreas/PrivateCompaniesPracticeSection/QualityServicesDelivery/KeepingUp/invigorate-the-focus), beneath the "Quality Control & Peer Review" heading. Access to the questionnaires is restricted to AICPA members.

Developing Policies and Procedures for Relevant Ethical Requirements

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. The authors believe that factors such as the size of the firm, the

number of firm locations, operating characteristics of the firm, the knowledge and experience of firm personnel, and the nature and complexity of the firm's practice, including whether it is part of a network, impact the QC policies and procedures for a given firm.

There is more than one way to develop a firm's quality control policies and procedures. For example, *PPC's Guide to Quality Control* chooses to develop one policy statement for each QC element or major section and then design 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 need to choose an approach in developing their QC policies and procedures that meets the needs and desires of the firm.

Prohibited Transactions and Relationships. Because of the sheer volume and complexity of the independence interpretations and other ethical requirements under the Code, employees cannot be expected to remember all the specifics of the ethical requirements governing the firm. Accordingly, the authors believe it is advisable to list as a part of the overall policy, the most common or obvious transactions, relationships, or circumstances that would impair the firm's independence and would, thus, violate its relevant ethical requirements policy. These are commonly referred to as "Prohibited Transactions and Relationships."

It is generally understood that certain transactions and relationships are prohibited. The independence interpretations cite examples of prohibited transactions and relationships. However, many firms may not want to arbitrarily prohibit all such transactions. For example, several of the firm's partners may have invested in a real estate joint venture with the owners of a significant client organization. The firm may be willing to issue a nonindependent compilation report on the client's financial statements rather than withdraw from the engagement. On the other hand, as a firm grows in size and in number of employees (especially as a firm's audit practice grows), it may be impractical to approach each independence question on an *ad hoc* basis. In this case, the firm may decide to prohibit all transactions that would impair its independence.

The most common types of transactions that impair independence and that are communicated to the firm's partners and employees in a prohibited transactions and relationships policy include:

- Investments in a client's business.
- Investments with a client or with client personnel.
- Borrowings from or loans to a client or a client's personnel; in this regard, past due accounts receivable from a client could be viewed as a loan.
- Accepting or offering gifts or entertainment from or to a client.
- Certain family relationships between professionals of the CPA firm and client employees.
- Involvement as directors and/or management of nonprofit organizations, banks, or other organizations.

An infinite variety of situations can occur that raise questions as to whether a particular situation is a threat to independence. When making independence judgments that are not explicitly addressed by the Code's independence interpretations, the guidance contained in the *Conceptual Framework for Independence* should be followed if the firm is unsure whether a situation may violate the Code. More information about applying the *Conceptual Framework for Independence* was provided earlier in this lesson.

Does the Policy Concerning Independence Apply to All Services and All Employees of the Firm? A potentially confusing consideration when adopting an independence policy is determining to whom it applies. The Code's *Independence Rule* and related interpretations, and independence rules of most state boards of accountancy and CPA societies are aimed at covered members. (Covered members include individuals on an attest engagement team and individuals in a position to influence the attest engagement. See ET 0.400.12 for the full definition of a *covered member*.) Independence does not apply to tax or consulting clients for which no attest services are provided, and, accordingly, professionals within the firm who work on those engagements are not subject to the independence requirements of the quality control system.

However, certain of the Code's independence interpretations apply to all partners, regardless of their functional or departmental classifications. For example, under the *Financial Interests* interpretation (ET 1.240.010.03), if a tax partner holds an investment of more than five percent in an audit client, independence would be impaired, even though that partner performs no services for the client. Also, the *Independence Rule* and related interpretations apply to partners or managers who provide ten or more hours of nonattest services to an attest client during a specified period and to partners in the office in which the lead attest engagement partner primarily practices with respect to an attest engagement (defined by the term *covered member*). Thus, if the firm has separate tax and consulting departments, the partners in those departments must adhere to some or all of the firm's independence policy and procedures, even though they may never perform accounting and auditing services.

Some firms use paraprofessionals to do accounting and review services and to assist in audit engagements. As previously mentioned, a covered member (to whom the independence rules apply) includes an individual on the attest engagement team. However, the Code's definition of *attest engagement team* excludes individuals who perform only routine clerical functions. The authors believe that a paraprofessional participating in an engagement, in any capacity other than providing administrative support, is acting as a professional. Consequently, the firm's quality control policy on relevant ethical requirements need only refer to professional personnel.

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 size, structure, and nature of the firm's practice. Documentation should provide sufficient evidence that the quality control policies and procedures were followed. As previously mentioned, a good starting point is to refer to the AICPA illustrative procedures reproduced at Exhibit 1-9.

Should the Firm Design a Separate Personnel Manual? An important consideration in designing a quality control system is to determine where the quality control procedures will reside and in what form they will be documented. Some firms develop a comprehensive quality control document that contains all personnel procedures related to the requirements of QC 10. Other firms may use both a quality control document and a personnel manual. Those firms might state a basic requirement for complying with relevant ethical requirements in the quality control document and make reference to the personnel manual for specific requirements. For example, the quality control document may contain the basic requirement that all employees must adhere to the firm's independence requirements and include a reference to the listing of prohibited transactions in the personnel manual. Larger firms may elect to cover all relevant ethical requirements in both the quality control document and the personnel manual.

Firms that use more than one document to cover their quality control system need to ensure that both documents are consistent and comprehensive. When working with two different documents, it is easy to inadvertently omit a procedure or have conflicting statements. The authors have designed a comprehensive quality control statement that includes all relevant ethical requirements, as well as personnel matters related to achieving compliance with relevant ethical requirements.

Communicate the Firm's Policies and Procedures to Employees. The authors recommend that, regardless of the firm's size, the firm's quality control system policies and procedures be communicated to its personnel in a written document. By doing so, communicating the firm's policy and procedures is rather easy, as the managing partner or personnel administrator can determine that each employee has received the written document. In addition, when distributing copies to employees, firm management can make it clear that each employee is required to be familiar with the contents of the document. Firms may also maintain a copy of the firm's QC policies and procedures available electronically, perhaps on the firm's network.

Many firms communicate their policy and procedures by attaching them to the annual employee independence representation that personnel are required to sign upon hiring and annually thereafter. Regardless of the method used to communicate the policy and procedures, circulating a copy along with the instructions for completing the employee independence representation letter is a good way to reemphasize the importance of adherence to the rules.

EVALUATING THE OVERALL ADEQUACY OF THE DESIGN OF THE QUALITY CONTROL SYSTEM

The authors' ideas, recommendations, and suggestions relating to relevant ethical requirements 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, of course, lies with the firm. To help determine whether the relevant ethical requirements policies and procedures meet the firm's needs and provide reasonable assurance that the firm complies with the quality control standards, firms can choose to use the quality control system practice aids included in *PPC's Guide to Quality Control*. Those practice aids provide a summary of what the quality control policies and procedures for each quality control element need to address. Reviewing the questions in the relevant ethical requirements section of the appropriate practice aid will be useful in performing a final assessment of the firm's quality control policies and procedures for this QC element.

Additionally, the authors suggest that the firm consider examples of independence matters noted in recent peer reviews. Exhibit 1-10 provides such information.

Exhibit 1-10

Independence Matters Noted in Peer Reviews

- Failure to obtain annual independence representations from staff.
 - Failure to verify the independence of *per diem* and contract employees or outside concurring reviewers used by a firm.
 - Failure to obtain annual independence representations from component auditors performing a segment of the group audit engagement.
 - Failure to circulate current lists of clients from whom the firm must be independent.
 - Failure to document or to adequately document resolution of independence questions.
 - Failure to document the timely review of client accounts receivable agings (billed and unbilled).
 - Staff are not familiar with independence requirements of the firm and of professional literature.
 - Failure to appropriately modify a compilation report on an engagement in which the accountant was not independent.
 - Failure to comply with regulatory independence rules. (For example, the U.S. Department of Labor's and Department of Housing and Urban Development's independence requirements are more stringent than those required by the AICPA's professional standards.)
 - Issuance of a review report or an audit report when the practitioner is not independent.
 - Failure to establish and document in writing the procedures required by the Code with regard to providing nonattest services to attest clients.
 - Failure to address management's responsibilities to oversee and evaluate the results of nonattest services performed for attest clients as required by the Code.
 - Failure to properly document independence considerations as required for Yellow Book engagements.
 - Failure to comply with SEC Independence Rules when performing a broker-dealer engagement.
 - Failure to understand and comply with the independence rules applicable to banks, including FDICIA, when performing those engagements.
-

MONITORING COMPLIANCE WITH RELEVANT ETHICAL REQUIREMENTS POLICIES AND PROCEDURES

The firm should review, on an ongoing basis, its relevant ethical requirements 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 relevant ethical requirements 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.

16. Which of the following statements most accurately describes an issue related to developing policies and procedures for relevant ethical requirements?
 - a. A firm's quality control policies and procedures in this area are pulled directly from the AICPA Practice Aid.
 - b. It is a best practice for a firm's independence policy to include a list of the most common prohibited transactions and relationships.
 - c. It is better for firms to approach independence issues on an *ad hoc* basis rather than prohibiting all problematic transactions and relationships.
 - d. The firm's policies and procedures for independence must apply to all of the firm's employees.
17. Which of the following is an independence matter often noted in peer reviews?
 - a. Issuance of a compilation report when the practitioner is not independent.
 - b. Excess documentation about independence considerations for Yellow Book engagements.
 - c. Not obtaining independence representations from component auditors.
 - d. Staff members spending too much time familiarizing themselves with independence requirements.

SELF STUDY ANSWERS

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

16. Which of the following statements most accurately describes an issue related to developing policies and procedures for relevant ethical requirements? **(Page 203)**
- a. A firm's quality control policies and procedures in this area are pulled directly from the AICPA Practice Aid. [This answer is incorrect. The AICPA Practice Aid (*Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice*) includes illustrative policies and procedures, but the firm should not put them in its quality control system as is. Factors such as the size of the firm, the number of firm locations, operating characteristics of the firm, the knowledge and experience of firm personnel, and the nature and complexity of the firm's practice, including whether it is part of a network, impact the QC policies and procedures for a given firm.]
 - b. **It is a best practice for a firm's independence policy to include a list of the most common prohibited transactions and relationships.** [This answer is correct. Because of the sheer volume and complexity of the independence interpretations and other ethical requirements under the Code, employees cannot be expected to remember all the specifics of the ethical requirements governing the firm. Accordingly, this course recommends listing, as part of the firm's overall policy, the most common or obvious transactions, relationships, or circumstances that would impair the firm's independence and would, thus, violate its relevant ethical requirements policy. These are commonly referred to as "Prohibited Transactions and Relationships."]
 - c. It is better for firms to approach independence issues on an *ad hoc* basis rather than prohibiting all problematic transactions and relationships. [This answer is incorrect. It is generally understood that certain transactions and relationships are prohibited. However, many firms may not want to arbitrarily prohibit such transactions, and would be willing to issue nonindependent compilation reports in some circumstances. On the other hand, this may be impractical as the firm grows in size and number of employees. Therefore, this is an issue that can vary by firm; one best practice will not fit all firms.]
 - d. The firm's policies and procedures for independence must apply to all of the firm's employees. [This answer is incorrect. The Code's *Independence Rule* and related interpretations, in independence rules of most state boards of accountancy and CPA societies are aimed at covered members but not to tax or consulting clients for which no attest services are provided, and, accordingly, professionals within the firm who work on those engagements are not subject to the independence requirements in the quality control system. However, certain of the Code's independence interpretations apply to all partners, regardless of their functional or departmental classifications. Also, some paraprofessionals may be covered and others may not be. Either way, firms must look at their employees and their duties to determine whether or not the rules apply.]
17. Which of the following is an independence matter often noted in peer reviews? **(Page 205)**
- a. Issuance of a compilation report when the practitioner is not independent. [This answer is incorrect. A common independence issue often noted in peer reviews is issuance of a review report or an audit report when the practitioner is not independent. It is appropriate for a practitioner to release a compilation report without being independent, but that report should be modified.]
 - b. Excess documentation about independence considerations for Yellow Book engagements. [This answer is incorrect. One independence matter that is often noted in peer reviews is the failure to properly document independence considerations as required for Yellow Book engagements.]
 - c. **Not obtaining independence representations from component auditors.** [This answer is correct. When evaluating the overall adequacy of the design of the quality control system, firms might want to consider examples of independence matters noted in recent peer reviews. One example of such an independence matter is the failure to obtain annual independence

representations from component auditors performing a segment of the group audit engagement.]

- d. Staff members spending too much time familiarizing themselves with independence requirements.
[This answer is incorrect. As noted in recent peer reviews, one example of a common independence matter is that staff are *not* familiar with independence requirements of the firm and of professional literature.]

Lesson 2: 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. This lesson discusses those concepts in more detail.

Learning Objectives:

Completion of this lesson will enable you to:

- Determine best practices for evaluating client acceptance and continuance issues, including competence and capabilities, compliance with legal and ethical requirements, the client's integrity, and other considerations.
- Recognize how to obtain the client's agreement on engagement terms, withdraw from the engagement, prepare appropriate quality control policies and procedures, and evaluate the adequacy of the firm's quality control system.

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 SSARS 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, *Concepts Common 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, those same authoritative pronouncements, as well as the authoritative literature of the AICPA *Code of Professional Conduct* (the Code), provide guidance that addresses the firm accepting and continuing client relationships and engagements. That information is discussed at various points in 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 2-1 through 2-4.

Exhibit 2-1

Requirements for Acceptance and Continuance QC Policies and Procedures under QC 10

Requirements	QC 10
<p>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—</p> <ul style="list-style-type: none"> • 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
<p>Such policies and procedures should—</p> <ul style="list-style-type: none"> • 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, <i>Conflicts of Interest</i>, such as disclosure of the relationship to the client and other appropriate parties, and (2) document the resolution of identified issues. 	QC 10.28
<p>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.</p>	QC 10.29
<p>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—</p> <ul style="list-style-type: none"> • 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 2-2**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 2-3**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 105.35(a)

Exhibit 2-4**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

EVALUATING THE FIRM'S COMPETENCE AND CAPABILITIES (INCLUDING TIME AND RESOURCES)

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 successfully completed the prior year engagement does not necessarily mean that the same result will be

repeated on this year's engagement. There are many possible circumstances that may have occurred at the firm level and/or client level that could significantly affect the performance of the next engagement. Considerations related to continuing client relationships and engagements are discussed further later in this lesson. 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, the authors are aware of many instances 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).
- Generally, nonprofits and state and local governments that expend federal awards exceeding \$750,000 are further subject to audits performed under the Single Audit Act. Also, the Coronavirus Aid, Relief, and Economic Security (CARES) Act allocated significant amounts of money in new aid to non-federal entities requiring many of them to undergo a single audit, some for the first time.
- 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.

COMPLIANCE WITH REQUISITE 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 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.
- 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. Lesson 1 discussed the ethical requirements of members in public practice.

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 where 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 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 105.35 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, the

authors believe this standard includes the documentation of this process. AR-C 60.A45 has the same indicators as AU-C 220.A7 that can assist the engagement partner in making that determination. AR-C 60.A46 explains 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.

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 those factors is 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. The authors believe 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 the authors believe it should be applied as defined in 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 discussed in more detail later in this section.

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 or 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 (a) that the client lacks integrity or (b) why the client is changing accountants (for example, 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. (*Familiarity threat* was defined in Lesson 1.)

Gathering Evidence of Integrity

The authors recommend that the firm 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, the authors believe that firms should 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 authors recommend that the firm 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.
- Profile as a corporate citizen.
- Fiscal responsibility.
- Formal company communications.
- Transparency.
- Interactions 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. Firms might consider the following in assessing the client's reputation:

- Online searches of local newspapers and trade publications may surface relevant issues to discuss with the prospective client.
- Other online searches for bankruptcy records, litigation history, Dun & Bradstreet reports, corporate filings, and corporate affiliations may provide information on prospective clients and their management.
- Reports filed with the Better Business Bureau are a good source of information regarding the business dealings of the entity.
- Useful information might be obtained from the prospective client's website, as well as from their social media presence, such as Facebook or LinkedIn.

Exhibit 2-5 provides sources of background information available to firms online.

Exhibit 2-5

SOURCES OF BACKGROUND INFORMATION

INFORMATION SOURCE	WEBSITE
Credit Rating Services	
Dun & Bradstreet (D&B)	www.dnb.com
Equifax	www.equifax.com
Experian	www.experian.com
Moody's Investors Service, Inc.	www.moody's.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	legal.thomsonreuters.com/en/products/clear-investigation-software
D&B Hoovers	www.dnb.com/products/marketing-sales/dnb-hoovers.html
LexisNexis	www.lexisnexis.com/en-us/home.page
ProQuest	www.proquest.com/products-services/proquest-dialog.html
PublicData.com	www.publicdata.com
S&P Global	www.spglobal.com/ratings/en/
General Business Information	
AnyWho	www.anywho.com
National White Pages	www.whitepages.com

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?

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.

Transparency. The transparency 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 transparency, 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. (It is a good idea to check with legal counsel prior to performing a background check to determine if there are any federal, state, or local laws that require permission from, or disclosure to, the prospective client.)

Interactions with Employees. How a company interacts 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 query of a general search engine 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. The predecessor communication provides the successor auditor with information about the client and management's integrity. Some of the inquiries the successor may make of the predecessor include:

- What is the predecessor's understanding of the nature of the entity's relationships and transactions with related parties and significant unusual transactions?
- Are there facts that might bear on the integrity of management?
- Were there disagreements with management about accounting principles or practices, audit scope, financial statement disclosures, or other similar significant matters?
- Were there any communications with those charged with governance regarding fraud and noncompliance with laws and regulations?
- 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.

Special Considerations—Attestation Engagements

Unlike the mandatory communication required by auditing literature, the SSAEs do not require a practitioner to communicate with a predecessor as a prerequisite to accepting an attestation engagement. However, the authors suggest that the practitioner who is considering accepting a new attestation engagement consider applying

procedures similar to the auditing procedures discussed in the “Predecessor Communications” paragraph above. Although predecessor communication is not required, the authors believe that it may be useful in providing valuable information to the practitioner, including facts that may bear on the integrity of management. If the prospective client refuses to provide permission for this communication with the predecessor, the practitioner needs to determine why. Such a refusal is considered by many practitioners to be sufficient reason to decline an engagement.

Special Considerations—SSARS Engagements

The SSARS also do not require an accountant 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.

EVALUATING OTHER CONSIDERATIONS RELATED TO THE CLIENT AND THE ENGAGEMENT, INCLUDING RISK

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 only undertakes or continues engagements that satisfy 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, which the firm does not currently possess and cannot immediately obtain.

Evaluating the Acceptability of Existing Client Relationships. One of the major deficiencies of QC systems relating to acceptance and continuance 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 find dismissing a marginally profitable client difficult, 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. It may be helpful for engagement partners to take note of any issues that arose during a particular engagement at the conclusion of the engagement, when the client relationship and specific engagement is fresh in the partner's memory. These notes could then be referred to prior to the annual partner meeting to help ensure that the firm's continuance decision considers all past client and engagement issues.

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 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 Do the Authors Prefer? Either approach to evaluating the ongoing acceptability of a client is an effective technique. The authors recommend adopting both procedures (a macro review of the client list and a micro review of each engagement) 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 for evaluating the client list is used, in the authors' opinion, the ultimate decision to dismiss a current client should 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 may indicate 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. The authors also suggest documenting 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 2-6. 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 2-6

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.
- 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 Private Companies Practice Section (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 by considering factors that may indicate if the firm can provide high quality and profitable services. Both tools are available at us.aicpa.org/interestareas/privatecompaniespracticesection/qualityservicesdelivery/keepingup/invigorate-the-focus.

Consideration of Risk

The level of risk involved in performing a particular engagement is addressed in the SASs, SSAEs, and SSARS. 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. The nature, timing, and extent of procedures can typically be expanded on first-year engagements to help mitigate any additional risk.

The remainder of this section discusses 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

As discussed in Lesson 1, 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.

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 the firm's resources may not be worth the cost on several levels.

Will the Engagement Constitute a Marginal Level of Practice? The authors believe that firms should also avoid developing a marginal level of practice in a given area (particularly a high-risk practice area, as discussed below). 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 professional 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. 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.

Audit Engagements. 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.

Audits of Public Companies (Issuers). 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*.
- Depository institutions subject to FDICIA.
- Broker-dealers.
- Examinations of service organizations.
- Technology companies.
- Real estate or construction companies.
- Telecommunication companies.
- Other financial services companies not subject to FDICIA, including banks, savings and loans, credit unions, and insurance companies.
- Health care entities, including hospitals and nursing homes.
- Nonprofit 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, real estate, and construction industries have cyclical business trends and 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 regulation/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, the firm needs to ensure that the engagement partner possesses subject matter expertise and experience in the relevant industry.

Accordingly, when deciding whether to accept an engagement in a specialized industry, firms ought to be aware of the need to assign more experienced staff to those engagements. Additionally, 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 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.

SELF-STUDY QUIZ

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

18. Which of the following requirements applies to members who outsource client work to third-party service providers?
 - a. Before engaging the third-party service provider, members should enter into a contractual agreement with them that requires confidentiality of client information.
 - b. Assuming no red flags are raised, members can assume that the third-party service provider has appropriate procedures in place to ensure the confidentiality of client information.
 - c. Members should inform their clients about the use of a third-party service provider if an issue arises with the confidentiality of client information sent to that provider.
 - d. Members should clarify that the third-party service provider is responsible that all work performed by them meets the necessary standards, both general and technical.
19. Which of the following licensing requirements will affect firms and their performance of professional services?
 - a. Firm licenses are required only in the state where their main office resides.
 - b. Each firm license should use a unique name.
 - c. Firm licenses should be obtained before any reports are issued.
 - d. If firm licenses are correctly maintained, individual employees do not need licenses.
20. Why might firms perform online searches of local newspapers and trade publications and read reports filed with the Better Business Bureau in relation to a potential client?
 - a. To determine the potential client's attitude toward aggressive accounting.
 - b. To obtain information about the nature of a prospective client's operations.
 - c. To assess the potential client's reputation.
 - d. To determine whether the prospective client is a good corporate citizen.
21. What circumstances might trigger a firm to consider discontinuing services to an existing client?
 - a. Paying the balance on its account with the firm.
 - b. Having the ability to continue as a going concern for at least a year.
 - c. Implementing firm recommendations in a timely fashion.
 - d. Changing the nature or scope of the engagement.
22. Which guidance applies to a firm's evaluation of practice area risk during client acceptance and continuance?
 - a. Performing only a few engagements in an area makes the firm well rounded.
 - b. Providing services that strain the firm's resources may not be worth the cost.
 - c. Performing fewer engagements in an area lowers the firm's risk in that area.
 - d. Tax and accounting engagements present the highest risk to firms.

SELF STUDY ANSWERS

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

18. Which of the following requirements applies to members who outsource client work to third-party service providers? **(Page 214)**
- a. **Before engaging the third-party service provider, members should enter into a contractual agreement with them that requires confidentiality of client information. [This answer is correct. As outlined in ET 1.700.040, 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 information. If there is no confidentiality agreement, specific client consent should be obtained before the member discloses confidential client information to the third-party service provider.]**
 - b. Assuming no red flags are raised, members can assume that the third-party service provider has appropriate procedures in place to ensure the confidentiality of client information. [This answer is incorrect. Per ET 1.700.040, 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.]
 - c. Members should inform their clients about the use of a third-party service provider if an issue arises with the confidentiality of client information sent to that provider. [This answer is incorrect. According to ET 1.150.040, 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.]
 - d. Members should clarify that the third-party service provider is responsible that all work performed by them meets the necessary standards, both general and technical. [This answer is incorrect. As discussed in ET 1.300.040, the accountant is responsible for all work performed, including work performed by third-party service providers, and ensuring that the services meet the general standards and all other applicable technical standards.]
19. Which of the following licensing requirements will affect firms and their performance of professional services? **(Page 216)**
- a. Firm licenses are required only in the state where their main office resides. [This answer is incorrect. Firms are required to obtain (and maintain) firm license(s), including licenses in states other than where the firm's main office is located, if necessary.]
 - b. Each firm license should use a unique name. [This answer is incorrect. In all states where the firm provides professional services, the firm should be licensed under the same name under which it practices.]
 - c. **Firm licenses should be obtained before any reports are issued. [This answer is correct. In all states where the firm provides professional services, certain licensing requirements must be met. These requirements include, among other things, (1) obtaining the license before any reports are issued in the state, (2) considering how variations in licensing body regulations affect the firm's practice in a particular state, and (3) addressing any restrictions that have been imposed by a licensing body.]**
 - d. If firm licenses are correctly maintained, individual employees do not need licenses. [This answer is incorrect. The firm's professional employees are also required to obtain and maintain a license to practice public accounting regardless of whether they practice as part of a firm that maintains firm

licenses. Each individual state board of accountancy establishes those licensing requirements, and firms should ensure that their professionals are maintaining appropriate licenses.]

20. Why might firms perform online searches of local newspapers and trade publications and read reports filed with the Better Business Bureau in relation to a potential client? **(Page 220)**
- a. To determine the potential client's attitude toward aggressive accounting. [This answer is incorrect. 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 or accountants, and other third parties such as bankers. Reviewing the financial statements and tax returns and reading internal communications, such as mission statements and procedures manuals, if available, may also provide insight. The sources of information listed above, however, would not shed light on this subject.]
 - b. To obtain information about the nature of a prospective client's operations. [This answer is incorrect. 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 sources of information above, however, would be better utilized for a different purpose.]
 - c. **To assess the potential client's reputation.** [This answer is correct. Part of evaluating a client's integrity is to assess the client's reputation. Possible sources of information about a potential client's reputation include (1) online searches of local newspapers and trade publications, which may surface relevant issues to discuss with the prospective client; (2) other online searches for bankruptcy records, litigation history, Dun & Bradstreet reports, corporate filings, and corporate affiliations, all of which may provide information on prospective clients and their management; (3) reports filed with the Better Business Bureau, which are a good source of information regarding the entity's business dealings; and (4) the client's website and social media presence, which may also provide useful information.]
 - d. To determine whether the prospective client is a good corporate citizen. [This answer is incorrect. To determine whether a prospective client is a good corporate citizen, a firm might (1) consider whether the business sponsors local charitable events, (2) make inquiries of local business groups or associations, or (3) determine whether any complaints have been filed with state or federal agencies. The sources of information mentioned above, however, provide information in a different area related to the potential client's integrity.]
21. What circumstances might trigger a firm to consider discontinuing services to an existing client? **(Page 225)**
- a. Paying the balance on its account with the firm. [This answer is incorrect. Significant unpaid fees that might cause an independence problem or create doubt about the collectability of future fees might cause a client to discontinue services to an existing client. The client paying off its balance would actually allay such issues.]
 - b. Having the ability to continue as a going concern for at least a year. [This answer is incorrect. The firm is more likely to consider discontinuing engagements in which the firm has substantial doubt about the entity's ability to continue as a going concern.]
 - c. Implementing firm recommendations in a timely fashion. [This answer is incorrect. If the client has ignored prior firm recommendations, such as recommendations regarding the interpretation of accounting standards or addressing internal control deficiencies, the firm is more likely to consider discontinuing providing services to that client.]
 - d. **Changing the nature or scope of the engagement.** [This answer is correct. One example of a reason a firm might consider discontinuing services to an entity on its client list is changes to the nature or scope of the engagement. This includes requests for additional services that the firm may not be adequately prepared to render.]

22. Which guidance applies to a firm's evaluation of practice area risk during client acceptance and continuance? **(Page 228)**
- a. Performing only a few engagements in an area makes the firm well rounded. [This answer is incorrect. This course suggests that firms should avoid developing a marginal level of practice in a given area (particularly high-risk areas). Firms need to clearly commit to providing services in a given area (thereby developing adequate expertise) or eliminate pursuing clients desiring such services altogether.]
 - b. **Providing services that strain the firm's resources may not be worth the cost.** [This answer is correct. 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 due to the time and effort it takes for the firm's audit partners and staff to remain familiar with the related professional standards. Also, the firm's audit personnel might not be able to obtain the necessary experience from such a small practice. Trying to provide services that significantly strain the firm's resources may not be worth the cost on several levels.]
 - c. Performing fewer engagements in an area lowers the firm's risk in that area. [This answer is incorrect. 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.]
 - d. Tax and accounting engagements present the highest risk to firms. [This answer is incorrect. Accountants' malpractice claim statistics historically show that tax and accounting services represent 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 are (1) audit engagements, (2) audits of public companies, and (3) prospective financial statement engagements.]

OBTAINING THE CLIENT'S AGREEMENT ON THE TERMS OF THE ENGAGEMENT

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 (AT-C 205A.07–.09) for assertion-based examinations, AT-C 206.09 for direct examinations, AT-C 210.08–.10 (AT-C 210A.08–.10) for reviews, and AT-C 215.14–.15 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 90.16–.17 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 SSAEs 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.

WITHDRAWING FROM AN ENGAGEMENT OR A CLIENT RELATIONSHIP

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. In the authors' opinion, an acceptance and continuance QC system should also provide guidance for situations that would cause a firm to withdraw. Some reasons that might cause a firm to withdraw from an engagement were provided 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 later in this section.

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 engagement letters in PPC audit and accounting products contain suggested sentences that inform clients that the firm has the right to withdraw.

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, the authors believe that any decision to withdraw from an engagement would be subject to those same consultation documentation procedures. One method for documenting an engagement withdrawal or withdrawal from both the engagement and the client relationship is by using the form provided in *PPC's Guide to Quality Control*.

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. The authors believe that, in most cases, the communication should be in writing, and PPC's audit and accounting products 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. The authors recommend that the QC system 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 200.29).
- 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 210.17).

- 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 220.13c).
- 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 their ability to continue performing the audit (AU-C 240.38).
- AU-C 250, *Consideration of Laws and Regulations in an Audit of the Financial Statements*, indicates—
 - The auditor may withdraw from the engagement when management or those charged with governance refuse to follow remedial action recommended by the auditor with regard to the entity's noncompliance in relation to other aspects of the engagement, regardless of whether the noncompliance is material to the financial statements (AU-C 250.A25).
 - The auditor may withdraw from the engagement if management or those charged with governance refuse to accept a modified opinion (AU-C 250.A27).
- AU-C 260, *The Auditor's Communication With Those Charged With Governance*, indicates that when the two-way communication between the auditor and those charged with governance is considered inadequate and unresolvable by the auditor, the auditor may withdraw from the engagement as one possible course of action (AU-C 260.A55).
- AU-C 510, *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements*, requires that the auditor evaluate 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 510.13).
- 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 580.25).
- 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, a disclaimer of opinion on the group financial statements would be necessary due to the group audit team's inability to obtain sufficient appropriate audit evidence (AU-C 600.16).
 - 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 600.48).
- AU-C 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, requires—
 - The auditor to consider the implications for the audit, which may include withdrawal, when the auditor has concerns as to whether the entity that prepared and certified the investment information as necessary for an ERISA Section 103(a)(3)(C) audit, is a qualified institution (AU-C 703.30; AU-C 703.A49).
 - The auditor to include an other-matter paragraph in the auditor's report, withhold the auditor's report, or withdraw from the engagement, when the auditor becomes aware of a material inconsistency between the draft Form 5500 and the ERISA plan financial statements prior to the report release date that would require revision of information in Form 5500, and management refuses to revise the information (AU-C 703.53).

- The auditor to take appropriate action when they conclude there is a material misstatement of fact in the draft Form 5500, as explained in AU-C 703.57–.59. In the situation where management refuses to correct the information, the auditor may take other appropriate actions, which include obtaining legal advice, withholding the auditor's report, or withdrawing from the engagement (AU-C 703.A85).
- 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 705.13).
- AU-C 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*—
 - Requires the auditor to (a) consider how the auditor's report would be affected and communicate the auditor's plans to address the situation with those charged with governance, (b) withhold the auditor's report, or (c) withdraw from the engagement when the auditor concludes that a material misstatement of the other information requiring revision exists prior to the report release date and management or those charged with governance do not correct the other information (AU-C 720.20–.21).
 - Indicates that in the circumstance where the auditor believes that a material inconsistency or a material misstatement of the other information may exist and is unable to conclude otherwise, the auditor may (a) obtain the advice of legal counsel, (b) consider whether and how the situation is to be addressed in the report, or (c) withdraw from the engagement (AU-C 720.A47).
- AU-C 725, *Supplementary Information in Relation to the Financial Statements as a Whole*, indicates that the auditor is precluded from expressing an opinion on supplementary information when the auditor's report on the audited financial statements contains an adverse opinion or disclaims an opinion. However, the auditor may withdraw from the engagement to report on supplementary information (AU-C 725.11).
- AU-C 810, *Engagements to Report on Summary Financial Statements*, requires that the auditor 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 810.19).
- AU-C 930, *Interim Financial Information*, requires the auditor to—
 - Withdraw from the engagement if management will not provide certain written representations (AU-C 930.23).
 - 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 (AU-C 930.27).
 - 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 (AU-C 930.37).
 - 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 930.42).
- AU-C 940, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*—
 - Requires the auditor to withdraw from the 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 940.74).
 - Indicates, when management includes additional information in management's report or includes additional information in a document containing management's report and the related auditor's report,

and such information includes a material inconsistency or a material misstatement of fact that is not corrected, the auditor should (a) communicate with those charged with governance as to how the auditor plans to address the situation in the report, (b) withhold the report, or (c) withdraw from the engagement (AU-C 940.80).

AU-C 220. In the performance of an audit engagement, AU-C 220.15 places responsibility on the engagement partner when they obtain 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. The following are discussed in the SSAEs as circumstances that may require the practitioner to withdraw from an attestation engagement:

- For assertion-based examination engagements [AT-C 205 (AT-C 205A)]—
 - The engaging party is the responsible party and does not provide a written assertion [AT-C 205.84 (AT-C 205A.82)].
 - The engaging party is not the responsible party and the responsible party does not provide an assertion or other requested representations either in writing or orally [AT-C 205.57b (AT-C 205A.56b)].
 - The engaging party is the responsible party and does not provide all the requested written representations, the representations provided are not considered to be reliable, or there is substantial doubt about the competence, integrity, or diligence of those providing the representations [AT-C 205.56c and AT-C 205.A68 (AT-C 205A.55c and AT-C 205A.A64)].
 - Sufficient appropriate evidence can not be obtained resulting in a scope limitation [AT-C 205.48 and AT-C 205.A119 (AT-C 205A.A109)].
 - Fraud or suspected fraud and/or noncompliance or suspected noncompliance with laws and regulations affecting the subject matter is identified [AT-C 205.A33–A34 (AT-C 205A.A29)].
 - The responsible party does not disclose a subsequent event that is necessary to prevent users from being misled [AT-C 205.A60 (AT-C 205A.A56)].
 - 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.A73 (AT-C 205A.A67))].
- For direct examination engagements (after SSAE No. 21 is implemented), AT-C 206 does not provide any unique withdrawal considerations, but refers to AT-C 205 for further consideration of requirements that also apply to AT-C 206. After SSAE No. 21 is implemented, practitioners should consider whether any of the withdrawal considerations in AT-C 205 apply to direct examination engagements.
- For review engagements [AT-C 210 (AT-C 210A)]—
 - The engaging party is the responsible party and does not provide a written assertion [AT-C 210.61 (AT-C 210A.59)].
 - The engaging party is the responsible party and does not provide all the requested written representations, the representations provided are not considered to be reliable, or there is substantial doubt

about the competence, integrity, or diligence of those providing the representations [AT-C 210.38 and AT-C 210.A51 (AT-C 210A.31 and AT-C 210A.38c)].

- The engaging party is not the responsible party and the responsible party does not provide requested representations either in writing or orally resulting in a scope limitation. (See the next bullet on scope limitations.) [AT-C 210.39b (AT-C 210A.39b)].
- Sufficient appropriate evidence is unable to be obtained resulting in a scope limitation [AT-C 210.60 (AT-C 210A.58)].
- Fraud or suspected fraud and/or noncompliance or suspected noncompliance with laws and regulations affecting the subject matter is identified (AT-C 210.A34–.35).
- The responsible party does not disclose a subsequent event that is necessary to prevent users from being misled (AT-C 210.A43).
- 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 210.A56).
- When the effects of a matter are material and pervasive (AT-C 210A.53). (Under SSAE No. 22, withdrawal is no longer required in this circumstance. Instead, AT-C 210.56 indicates that the practitioner should express an adverse conclusion when sufficient appropriate review evidence is obtained and the practitioner concludes that misstatements are material and pervasive to the subject matter. Adverse conclusions are not permitted under the extant guidance.)
- For agreed-upon procedures engagements—
 - The engaging party will not provide a written agreement of the procedures to be performed and acknowledgment that procedures are appropriate for the intended purpose of the engagement (AT-C 215.23).
 - The engaging party is the responsible party and does not provide the requested written representations, the practitioner has sufficient doubt about the engaging party's competence, integrity, or diligence, or the representations are otherwise not reliable, and it is not appropriate to restrict the use of the report or disclose the situation in the report (AT-C 215.30, AT-C 215.A45).
 - The engaging party is not the responsible party and the responsible party does not provide the requested written representations, and it is not appropriate to restrict the use of the report or disclose the situation in the report (AT-C 215.30, AT-C 215.A45).
 - The practitioner determines that the description of the procedures performed or the related findings are misleading, and it is not appropriate to perform revised procedures or reword a procedure or finding (AT-C 215.33, AT-C 215.A48).

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).
- In a preparation engagement, management does not provide additional or corrected information that is requested by the accountant, and the accountant can not disclose the matter in the financial statements (AR-C 70.17).
- In a compilation engagement, 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 compilation engagement, the modification of the standard report on the financial statements does not adequately identify the deficiencies in the financial statements as a whole (AR-C 80.32).
- In a review engagement, independence is impaired (AR-C 90.10).
- In a review engagement, the accountant determines that lack of management integrity weakens the reliability of the client representation letter or management does not provide a representation letter (AR-C 90.63).
- The reviewed financial statements are materially misstated due to fraud or noncompliance with laws and regulations (AR-C 90.36).
- From the review procedures performed, the accountant is unable to obtain sufficient appropriate evidence to form a conclusion (AR-C 90.48).
- In a review engagement, when the accountant learns about a subsequently discovered fact prior to the report release date and management refuses to revise the financial statements even though the accountant believes revision is needed (AR-C 90.53).

QUALITY CONTROL POLICIES AND PROCEDURES

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 tool 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 authors recommend that the illustrative examples found in the AICPA Practice Aid for designing the acceptance and continuance element of the quality control system be considered.

Exhibit 2-7 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 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 2-7

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 paragraphs .27–.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.
 - If a potential conflict of interest is identified in accepting an engagement from a new or existing client, the firm determines whether it is appropriate to accept the engagement. If issues have been identified and the firm decides to accept or continue the client relationship or a specific engagement, the firm considers whether ethical requirements included in the *Conflicts of Interest* Interpretation (ET 1.110.010) apply, such as disclosure of the relationship to the client and other appropriate parties, and documents how the issues were resolved.
 - 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 provide a logical starting point for designing the acceptance and continuance quality control system, the authors urge careful consideration of the firm's needs 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.

Peer Reviewers Evaluate Firm QC System Design. During the planning phase of a firm's peer review, the peer reviewer completes a questionnaire to evaluate the design of the firm's quality control policies and procedures. The questionnaire concentrates on the QC 10 requirements for each element of quality control, but also considers the related application guidance. Reviewers consider if a firm's documented quality control policies and procedures do not address the guidance in QC 10 because such a situation may indicate that the firm's system of quality control

could be out of compliance with professional standards. Firms may access those same questionnaires in the AICPA Peer Review Program Manual (PRPM); section 4600 of the PRPM presents the questionnaire for firms with two or more personnel and section 4500 of the PRPM presents the questionnaire for a sole practitioner with no personnel. The authors recommend that practitioners involved in designing and maintaining the firm's QC system read the 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 also available on the AICPA's Enhancing Audit Quality Initiative resources web page at us.aicpa.org/interestareas/privatecompaniespracticesection/qualityservicesdelivery/keepingup/invigorate-the-focus, beneath the "Quality Control & Peer Review" heading. Access to the questionnaires is restricted to AICPA members.

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. The authors believe that factors such as the following can 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 and *PPC's Guide to Quality Control* choose to develop one policy statement for each QC element and then design 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 2-7.

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. The AICPA's client evaluation tools, discussed earlier in this lesson, may also be used to assist the firm with making an initial (or continuing) client and engagement decision.

EVALUATING THE OVERALL ADEQUACY OF THE DESIGN OF THE QUALITY CONTROL SYSTEM

The authors' ideas, recommendations, and suggestions relating to acceptance and continuance 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. To help determine whether the acceptance and continuance policy and procedures meet the firm's needs and provide reasonable assurance that the firm complies with the QC standards, firms can choose to use the quality control system practice aids included in *PPC's Guide to Quality Control*. Those

practice aids provide a summary of what the QC policy and procedures for each QC element need to address. Reviewing the questions in the acceptance and continuance section of the appropriate practice aid will be useful in performing a final assessment of the firm's QC policy and procedures for this quality control element.

Additionally, the authors suggest that the firm consider examples of acceptance and continuance matters noted in peer reviews. Exhibit 2-8 provides examples of the significant matters noted in previous years' peer reviews.

Exhibit 2-8

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.
- Failure to obtain an engagement letter or failure to include all elements within the engagement letter as required by professional standards.

MONITORING COMPLIANCE WITH ACCEPTANCE AND CONTINUANCE 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.

23. Which of the following guidance applies when a firm withdraws from an engagement or client relationship?
- a. Withdrawal must occur before the engagement commences.
 - b. It is important for a decision to withdraw or discontinue services be in writing.
 - c. The firm will need to report any withdrawal to regulatory authorities.
 - d. It is unnecessary to document discussion of a possible withdrawal if the firm does not actually withdraw from the engagement.
24. Which of the following statements best describes an issue that could arise with respect to a firm's quality control policies and procedures related to client acceptance and continuance?
- a. One preferred method for evaluating a new client is to adopt a standard acceptance checklist.
 - b. The policies need to be developed before the overall policy.
 - c. Example policies and procedures provided by the AICPA will typically meet a firm's needs in this area.
 - d. Firms are prohibited from consulting the AICPA Peer Review Program Manual (PRPM) when developing policies and procedures.

SELF STUDY ANSWERS

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

23. Which of the following guidance applies when a firm withdraws from an engagement or client relationship? **(Page 238)**
- a. Withdrawal must occur before the engagement commences. [This answer is incorrect. The suggested acceptance and continuance procedures discussed in this course are designed to be performed before work commences on an engagement. However, 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 is begun. Therefore, it is a best practice for the acceptance and continuance quality control system to also provide guidance for situations that would cause a firm to withdraw at such a later time.]
 - b. **It is important for a decision to withdraw or discontinue services be in writing. [This answer is correct. 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. It is a best practice that, in most cases, the communication be in writing. In many cases, the firm may need to contact legal counsel to determine the most appropriate method of making this communication.]**
 - c. The firm will need to report any withdrawal to regulatory authorities. [This answer is incorrect. 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 (1) professional and legal responsibilities that apply, including whether there is a requirement for the firm to report to regulatory authorities and (2) the possibility of withdrawing from the engagement or ending the client relationship. Based on this guidance, reporting to regulatory authorities is a possibility but not always mandatory.]
 - d. It is unnecessary to document discussion of a possible withdrawal if the firm does not actually withdraw from the engagement. [This answer is incorrect. 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.]
24. Which of the following statements best describes an issue that could arise with respect to a firm's quality control policies and procedures related to client acceptance and continuance? **(Page 248)**
- a. **One preferred method for evaluating a new client is to adopt a standard acceptance checklist. [This answer is correct. 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.]**
 - b. The policies need to be developed before the overall policy. [This answer is incorrect. This is the reverse order. Once overall policy statements are formulated, the next step is to design the procedures needed to implement and monitor the policies.]
 - c. Example policies and procedures provided by the AICPA will typically meet a firm's needs in this area. [This answer is incorrect. While the AICPA's illustrative policies and procedures provide a logical starting point for designing the acceptance and continuance quality control system, this course urges firms to carefully consider their needs before adopting them. Firms may find that the example policies and procedures do not fully meet their firm's particular needs. The AICPA's illustrative policies and procedures are not meant to be all-inclusive, and firms are not limited to using only them.]

- d. Firms are prohibited from consulting the AICPA Peer Review Program Manual (PRPM) when developing policies and procedures. [This answer is incorrect. Firms may access the same questionnaires that peer reviewers use to plan peer reviews in the PRPM. This course recommends that firms read the questionnaire for their firm size when designing and maintaining their QC system. The AICPA also makes this recommendation.]

EXAMINATION FOR CPE CREDIT

Companion to PPC's Guide to Quality Control—Course 2—Ethical Requirements and Client Acceptance and Continuance (GQCTG222)

Testing Instructions

1. Following these instructions is an **Examination for CPE Credit** consisting of multiple choice questions. 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 those 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 the PDF and can be printed if needed.
2. **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 \$109 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.
3. **PRINT GRADING.** If you prefer, you may email, fax, or mail your completed answer sheet, as described below (\$109 for email or fax; \$119 for regular mail). The answer sheet is found at the end of the **Examination for CPE Credit**. Answer sheets may be printed from the PDF; they can also be scanned to send via email, if desired. Each answer sheet is identified with the course acronym. Please ensure you use the correct answer sheet for the course. 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
GQCTG222 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.

If you change your answer, remove your previous mark completely. Any stray marks on the answer sheet may be misinterpreted.

4. Each answer sheet sent for print grading must be accompanied by the appropriate payment (\$109 for answer sheets sent by email or fax; \$119 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 \$310 (a 5% discount on all three courses). If you complete four courses, the price for grading all four is \$392 (a 10% discount on all four courses). Finally, if you complete five courses, the price for grading all five is \$463 (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.

5. To receive CPE credit, completed answer sheets must be postmarked or entered into the Online Grading Center by **April 30, 2023**. CPE credit will be given for examination scores of 70% or higher.
6. When using our print grading services, only the **Examination for CPE Credit Answer Sheet** and the **Self-study Course Evaluation** should be submitted. **DO NOT SEND YOUR SELF-STUDY COURSE MATERIALS**. Be sure to keep a completed copy of the answer sheet for your records.
7. Please direct any questions or comments to our Customer Service department at (800) 431-9025 (Option 2).

EXAMINATION FOR CPE CREDIT

Companion to PPC's Guide to Quality Control—Course 2—Ethical Requirements and Client Acceptance and Continuance (GQCTG222)

Determine the best answer for each question below. Then mark your answer choice on the Examination for CPE Credit Answer Sheet. The answer sheet is located at the end of the exam and can be printed out, if desired. Alternatively, it can be accessed by logging onto the Online Grading System.

1. The requirements found in AR-C 60 relate to which of the following?
 - a. Audit documentation about issues that were identified and how they were resolved.
 - b. Engagement-level quality control requirements for engagement partners.
 - c. The use of observation and inquiry to check on noncompliance by the engagement team.
 - d. Policies and procedures designed to provide assurance that the firm complied with relevant ethical requirements.
2. How many conceptual frameworks are provided in the AICPA *Code of Professional Conduct* (the Code)?
 - a. One that applies to members in public practice.
 - b. Two: one for members in public practice and one for members in private practice.
 - c. Two: one for members in public practice and one for members in business.
 - d. Three: one for firms, one for individual members, and one for CPA clients.
3. Which of the following should members do when complying with the *Conceptual Framework for Members in Public Practice*?
 - a. When a threat is identified, the member should assume that there has been a violation of the Rules.
 - b. One or more safeguards should be applied when a threat to compliance with the Rules is not at an acceptable level.
 - c. If a threat is identified, the member must withdraw from the engagement even if safeguards have been applied.
 - d. When determining how to react to an ethical conflict, the member must decide based on professional judgment without consulting others.
4. Joseph's client indicates it plans to sue him over last year's audit engagement. This is an example of which of the following threats to compliance with the Rules outlined in the Code?
 - a. Adverse interest threat.
 - b. Management participation threat.
 - c. Self-review threat.
 - d. Undue influence threat.

5. Which of the following arises when members encounter obstacles that prevent them from following an appropriate course of action due to (1) internal pressures, (2) external pressures, and/or (3) conflicts in applying relevant professional or legal standards?
 - a. Threats to compliance.
 - b. Safeguards.
 - c. Ethical conflicts.
 - d. Loss of integrity.
6. Who is **not** subject to the ethical rules and regulations set forth by the AICPA, state boards of accountancy, state societies of CPAs, state statutes, and other regulatory agencies (e.g., GAO, DOL)?
 - a. Members of the AICPA.
 - b. CPAs in public practice.
 - c. Administrative staff.
 - d. All CPAs.
7. How is objectivity similar to integrity?
 - a. It relates to the individual's state of mind.
 - b. It is an ethical decision made before each engagement.
 - c. It can be maintained despite conflicts of interest.
 - d. It is a matter of fact, but not a matter of appearance.
8. Which of the following should members do under the Scope and Nature of Services rule?
 - a. Maintain their objectivity and integrity.
 - b. Only undertake services that can be completed with professional competence.
 - c. Perform professional services for a contingent fee.
 - d. Practice in a firm that has a quality control system.
9. Gunther accepts a gift from his audit client that has an unreasonably high value under the circumstances. This is a violation of which of the following?
 - a. *The Integrity and Objectivity Rule.*
 - b. *The Independence Rule.*
 - c. *The General Standards Rule.*
 - d. *The Accounting Principles Rule.*
10. Discrimination, harassment, failure to file a tax return, and negligence in preparing financial statements or records are violations of which of the following?
 - a. The Compliance with Standards Rule.
 - b. The Acts Discreditable Rule.
 - c. The Confidential Client Information Rule.
 - d. The Form of Organization and Name Rule.

11. Members in public practice are always prohibited from doing which of the following?
 - a. Accepting a contingent fee for any tax services.
 - b. Providing investment advisory services for a contingent fee.
 - c. Performing professional services for a contingent fee.
 - d. Using advertising to solicit new clients.
12. Which of the following is a requirement of the *Form of Organization and Name Rule*?
 - a. Members may practice public accounting in any type of organization.
 - b. Members must practice public accounting under a firm name that is not misleading.
 - c. If one CPA owner is a member of the AICPA, the firm can be identified as "Members of the American Institute of Certified Public Accountants."
 - d. Successor firms are prohibited from including the names of former owners in the new firm's name.
13. What guidance should practitioners consult when making independence decisions on matters not covered by the Code?
 - a. SQCS No. 8, *A Firm's System of Quality Control*.
 - b. *Conceptual Framework for Members in Public Practice*.
 - c. *Conceptual Framework for Independence*.
 - d. *Government Auditing Standards* (the Yellow Book).
14. If the requirements of the *Nonattest Services* Interpretation were not met when a member provided nonattest services to an attest client, what is one mitigating circumstance that could still help the member retain independence?
 - a. The nonattest services are provided during the period of the professional attest engagement.
 - b. The nonattest services related to periods prior to that of the financial statements being audited.
 - c. Another firm will reaudit the financial statements after the member completes his or her audit.
 - d. The member only performs nonattest services after the date of the auditor's report and before the next year's attest engagement begins.
15. Which of the following is true in relation to performing multiple nonattest services for an attest client?
 - a. Performing one nonattest service generally will not impair independence, but performing multiple nonattest services always will.
 - b. Members are prohibited by the *Nonattest Services* Interpretation from performing multiple nonattest services for an attest client.
 - c. Performing multiple nonattest services for an attest client may increase the significance of threats to independence and must be evaluated.
 - d. Nonattest services performed for attest clients by other network firms in the member's firm network are considered threats to the member's independence.

16. A member's independence will always be impaired by doing which of the following for an attest client?
- a. Attending board meetings in an advisory capacity.
 - b. Having custody of client assets.
 - c. Communicating summary data to the trustee of an employee benefit plan.
 - d. Recommending position descriptions or candidate specifications for hiring.
17. Which of the following bookkeeping, payroll, or other disbursement activities would impair independence?
- a. Preparing financial statements based on the trial balance.
 - b. Generating unsigned checks using source documents from the client.
 - c. Approving vendor invoices for payment.
 - d. Preparing a reconciliation that identifies reconciling items for the client's evaluation.
18. Who typically has the primary responsibility for identifying all services performed for a client and whether such services impair independence?
- a. A staff member on the engagement team.
 - b. The engagement partner.
 - c. The partner in charge of the firm's quality control system.
 - d. A member of the client's senior management.
19. Which of the following is a safeguard that helps preserve independence when member firms loan staff to clients under staff augmentation arrangements?
- a. The firm and the client have a regular staff augmentation arrangement that is predictable and long-standing.
 - b. The staff augmentation arrangement occurs every year at a specific time.
 - c. The staff augmentation arrangement will last less than 30 days.
 - d. The loaned staff provide nonattest services to the client with little supervision.
20. According to ET 1.295.143, does providing hosting services impair a member's independence?
- a. Yes, independence is impaired under the management participation threat.
 - b. Yes, but independence can be retained if appropriate safeguards are put in place.
 - c. No, because the client is still presumed to maintain internal control over its data.
 - d. No, as long as only back-up services are provided independence is not impaired.

21. Which of the following statements best describes an independence concern related to group audits?
- a. Each auditor or firm involved in the group audit has its own independence requirements; such requirements are not shared.
 - b. Component auditors are considered *other auditors* and should be treated as such in relation to independence matters.
 - c. Group audit guidance applies to all audits of group financial statements, even if the only auditors involved are those on the primary engagement team.
 - d. A component auditor's independence does not matter unless reference is made to their work in the auditor's report on the group financial statements.
22. Which of the following occurs when other accountants are involved in a review engagement?
- a. No communication with the other auditors is necessary unless reference will be made to them in the review report.
 - b. The accountant must ensure that the work performed by the other auditors is adequate if it will be used in the review engagement.
 - c. A review report can be based on another accountant's compilation report of a significant component of the review client.
 - d. As long as the primary accountant is familiar with the financial reporting framework used for the review engagement, other auditors do not have to be.
23. Can a firm's policies and procedures related to independence allow the firm to choose **not** to be independent from clients?
- a. Yes, as long as it recognizes it cannot perform attest services for clients from which it is not independent.
 - b. Yes, as long as the resulting ethics violations are minor enough that they can be safely ignored.
 - c. No, it is a best practice for policies and procedures to be inflexible to ensure that the firm remains independent from all clients.
 - d. No, policies and procedures that allow a lack of independence are a violation of QC 10.
24. According to QC 10.25, how often should firms obtain confirmations of compliance with its independence policies and procedures from all firm personnel who are required to be independent?
- a. Monthly.
 - b. Every six months.
 - c. Annually.
 - d. Every other year.
25. Which of the following often occurs in relation to the engagement partner's consideration of independence?
- a. This consideration occurs as part of the fieldwork of an audit engagement.
 - b. As long as general ethics requirements are met, the engagement partner has completed this step.
 - c. Conclusions about independence should be included in the audit documentation.
 - d. The engagement partner determines the appropriate course of action if a threat to independence cannot be eliminated.

26. Geller & Green is a large CPA firm. Instead of communicating prohibited client relationships to its employees, the firm requires employees to provide a list of their personal investments; interests in partnerships and joint ventures; loans receivable and payable; and family relationships with owners, directors, or officers of any company. Who is responsible for matching the investments and relationships on these lists to the firm's client list?
- a. Each employee is responsible for their own list.
 - b. The ethics partner is responsible for all lists.
 - c. Engagement partners are responsible for the lists of employees on the engagement team.
 - d. Firm management is responsible for all lists.
27. What is an advantage of communicating the resolution of an independence matter to affected engagement staff?
- a. It increases confidentiality and privacy among engagement team members.
 - b. It eliminates the need to create documentation about the issue in the workpapers.
 - c. It nullifies the requirement to determine whether previously issued reports are affected.
 - d. It provides a good training opportunity related to independence matters.
28. What is the first thing firms should do when designing new quality control policies and procedures?
- a. Review authoritative literature.
 - b. Determine how the new policies and procedures might fail.
 - c. Submit the new policies and procedures for peer review.
 - d. Consider examples provided in the AICPA Practice Aid.
29. Which of the following is an independence matter often noted in peer reviews?
- a. Representations are only obtained from staff annually.
 - b. Independence is verified for contract employees unnecessarily.
 - c. The resolution of independence questions are not adequately documented.
 - d. Lists of clients are circulated through the firm too frequently.
30. A potential audit client contacts Jill. When performing her engagement acceptance procedures, Jill realizes that she does not have the expertise needed to perform an audit in this industry. Can Jill still accept this engagement?
- a. Yes, Jill can accept this engagement and perform it to the best of her ability with the expertise she has.
 - b. Yes, Jill can accept this engagement if she can obtain the necessary knowledge over the course of the engagement.
 - c. No, Jill cannot accept this engagement unless she hires someone else who has the necessary knowledge to assist.
 - d. No, Jill is prohibited from accepting this engagement under the *General Standards Rule*.

31. Can a firm accept a new engagement if it will be unable to meet the deadline requested by the client?
- Yes—deadlines requested by clients are typically flexible and can be negotiated.
 - No—deadlines must be met as requested, so the firm cannot accept an engagement with deadlines it cannot meet.
 - Maybe—deadlines imposed by legal or regulatory entities must be met, but other client-imposed deadlines might be negotiable.
 - Maybe—but it is the client's responsibility to determine whether the deadline is negotiable, not the firm's.
32. Can a firm accept or continue an engagement if it has a conflict of interest?
- Yes—conflicts of interest do not affect engagement acceptance and continuance decisions.
 - No—firms are required by QC 10.28 to decline any engagements for which they have a conflict of interest.
 - Maybe—firms are required to decline any new engagements for a conflict of interest, but continuing engagements are exempt from this rule.
 - Maybe—it depends on if the issues can be resolved, and the *Conflicts of Interest* Interpretation should be consulted.
33. If, while performing its client acceptance and continuance procedures, a firm determines that a potential or existing client lacks integrity, can it still perform the engagement?
- Yes—the engagement can be performed if appropriate safeguards are in place.
 - No—QC 10 prevents the firm from accepting or continuing the engagement under these circumstances.
 - Maybe—it is a matter of professional judgment based on the severity of the lack of integrity.
 - Maybe—the firm is prevented from accepting a new engagement under these circumstances, but an existing relationship can be continued with caution.
34. Which of the following statements best describes an issue that may arise when evaluating a client's integrity?
- If key members of the client's management team have integrity, the firm can assume that the client as a whole has integrity.
 - If the client has a legitimate reason for asking the firm to reduce the time needed for fieldwork, such as an earlier deadline, it is not considered a scope restriction.
 - If a potential client does not grant the firm permission to contact its predecessor, this could indicate a lack of integrity.
 - Having a long and familiar relationship with a client makes it easier to recognize integrity issues.
35. Which of the following generally indicates integrity?
- Transparency.
 - Being selective about contacts.
 - Frequent turnover in management.
 - Issues meeting financial obligations.

36. According to QC 10.28, a firm should gather all the necessary acceptance or continuance information about a client by what point in the engagement?
- a. Before a new client is accepted or work on the continuing engagement begins.
 - b. Before fieldwork on the new or continuing engagement begins.
 - c. Before fieldwork on the new or continuing engagement is complete.
 - d. Before the report is issued at the conclusion of the new or continuing engagement.
37. Which of the following considerations is important when deciding whether to accept clients in a high-risk industry?
- a. The ability to assign low-level staff members to the engagement in order to provide them with more experience in that area.
 - b. How many clients the client has in the industry or how much it wants to expand into that industry (i.e., critical mass).
 - c. Whether the firm can change its established criteria to make sure an engagement quality control review (EQCR) is not needed.
 - d. Whether the firm can complete the engagement and maintain independence from the client in both fact and appearance.
38. How should the client's agreement on the terms of the engagement be documented?
- a. Orally, at a meeting with the client.
 - b. Orally or in writing, depending on the client's preference.
 - c. In writing, as part of the firm's workpapers for the engagement.
 - d. In writing, using an engagement letter or another suitable form.
39. Generally, who is responsible for deciding when a firm should withdraw from an engagement?
- a. The engagement team.
 - b. The managing partner.
 - c. Those charged with governance.
 - d. An appropriate regulatory body, such as the AICPA or the GAO.
40. Which of the following is a common matter noted in peer reviews related to acceptance and continuance?
- a. Too many formal policies and procedures related to acceptance and continuance.
 - b. Failing to reevaluate continuance decisions more than once per year.
 - c. Failing to obtain a license in all states where engagements were accepted.
 - d. Quality control policies focused on procedures for providing new services to existing clients.

EXAMINATION FOR CPE CREDIT ANSWER SHEET

Companion to PPC's Guide to Quality Control—Course 2—Ethical Requirements and Client Acceptance and Continuance (GQCTG222)

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 answers 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.	○	○	○	○

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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:	Low (1) . . . to . . . High (10)									
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GLOSSARY

AICPA Practice Aid: *Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, published by the AICPA. This is a tool to help practitioners develop the policies and procedures that comprise a firm's system of quality control.

Adverse interest threat: Whether the member will not act with objectivity because the member's interests and those of the client are in opposition.

Advocacy threat: Whether a member's objectivity or independence is compromised due to promoting a client's interests or position.

Client: In relation to client acceptance and continuance, the client includes the entity's principle owners, key management, and *those charged with governance*. Any related parties and individuals who have more than just a passing involvement with the business may also be considered.

Component: Any entity or business activity for which group or component management prepares financial information that is required by accounting standards to be included in the group financial statements.

Component auditor: An auditor who performs work on the financial information of a *component* that will be used as audit evidence for a *group audit*. They may be part of the group engagement partner's team, a network firm of the group auditor, or another auditing firm.

Due care: This requires competence and diligence, and it obligates performance of professional services to the best of an AICPA member's ability.

Ethical conflicts: These arise when a member encounters obstacles that prevent the member from following an appropriate course of action due to internal or external pressure and/or conflicts in applying relevant professional standards or legal standards.

Familiarity threat: Whether a member will become too sympathetic to a client's interests or too accepting of the client's work or product due to having a long or close relationship with the client.

Group audits: Audits of group financial statements, which are financial statements that include the financial information of more than one *component*.

Independence: Avoiding relationships that may appear to impair *objectivity* when providing attest services. Members must be independent in both fact and appearance.

Integrity: A firm's adherence to a code of moral values; it's incorruptibility. Members with integrity are honest and candid, yet respect client confidentiality; they cannot act with deceit or subordination of principle. It is measured in terms of what is right and just, and it requires a member to observe the principles of *objectivity*, *independence*, and *due care*.

Management participation threat: Whether a member will function as a client's management or otherwise assume management responsibilities for a client.

Objectivity: Being able to express or deal with facts or conditions without allowing them to be distorted by personal feelings, prejudices, or interpretations. It is a state of mind that adds value to a member's services, but also imposes an obligation to be impartial, intellectually honest, and free of conflicts of interest.

Quality control policies: These are designed to achieve the overall objectives of a firm's quality control system and the specific objectives of the individual elements of quality control.

Quality control procedures: These are designed to provide the actions necessary to implement and monitor compliance with stated *quality control policies*.

Safeguards: Actions that can be taken to eliminate threats to compliance with Rules or Interpretations of the *Conceptual Framework for Members in Public Practice*. They can be created by the profession, legislation, or regulation, implemented by the firm, or implemented by the client.

Self-interest threat: Whether a member could benefit, financially or otherwise, from an interest in or relationship with a client or individuals associated with the client.

Self-review threat: Whether a member (1) will not appropriately evaluate the results of a judgment made or service performed or supervised by the member or someone else in the firm and (2) will rely on that service when making judgment as part of another service.

Staff augmentation arrangement: When a firm provides human resource capital as a service to clients (i.e., loaning staff).

Those charged with governance: 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. This may include management personnel.

Undue influence threat: Whether a member will subordinate their judgment to that of someone associated with a client or any relevant third party due to that person's reputation, expertise, aggressive or dominant personality, or attempts to coerce or exercise influence over the member.

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