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AICPA PROFESSIONAL STANDARDS

Volume 2

Accounting & Review Services

Code of Professional Conduct

Bylaws

International Accounting

International Auditing

Consulting Services

Quality Control

Peer Review

Tax Practice

Personal Financial Planning

Continuing Professional Education

As of June 1, 1996



American Institute of
Certified Public Accountants

QC Section

STATEMENTS ON QUALITY CONTROL STANDARDS

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QC Section 10

System of Quality Control for a CPA Firm

(This statement provides that a CPA firm shall have a system of quality control and describes elements of quality control and other matters essential to the effective implementation of the system.)

November 1979

Statements on Quality Control Standards are issued by the Quality Control Standards Committee, the senior technical committee of the Institute designated to issue pronouncements on Quality Control Standards. Firms that are members of the AICPA Division for CPA Firms are obligated to adhere to Quality Control Standards promulgated by the Institute. All AICPA members should be aware that they may be called upon to justify departures from this Statement.

.01 Quality control for a CPA firm, as referred to in this statement, applies to all auditing and accounting and review services for which professional standards have been established.¹ Although the provisions of this statement may be applied to other segments of a firm's practice, such as providing tax services or management advisory services, their applicability to those segments of practice is not prescribed by this statement, except to the extent that such services are a part of the abovementioned auditing and accounting and review services.

.02 In providing professional services, a firm has a responsibility to conform with professional standards. In accepting this responsibility, there is a presumption that the firm will consider the integrity of individuals in determining its professional relationships, that the firm and its people will be independent of its clients to the extent required by the AICPA's rules of conduct, and that the firm's personnel will be professionally competent, will be objective, and will exercise due professional care.² To provide itself with reasonable assurance of meeting its responsibility to provide professional services that conform with professional standards, a firm shall have a system of quality control.

¹ Firm is defined in the AICPA rules of conduct as "A proprietorship, partnership, or professional corporation or association engaged in the practice of public accounting, including individual partners or shareholders thereof." *Professional standards*, as referred to in this statement, are those that relate to the professional qualities and performance of individual members of the AICPA and, accordingly, include the rules of conduct of the AICPA, pronouncements of the AICPA Auditing Standards Board and its predecessor committees, and pronouncements of the AICPA Accounting and Review Services Committee.

² Unless the text states otherwise, the term *personnel* encompasses all of a firm's professionals performing services to which this statement applies and includes proprietors, partners, principals, and stockholders or officers of professional corporations, and their professional employees.

System of Quality Control

.03 A system of quality control for a firm encompasses the firm's organizational structure and the policies adopted and procedures established to provide the firm with reasonable assurance of conforming with professional standards. The system of quality control should be appropriately comprehensive and suitably designed in relation to the firm's organizational structure, its policies, and the nature of its practice.

.04 Any system of quality control has inherent limitations that can reduce its effectiveness. Variance in individual performance and understanding of professional requirements affects the degree of compliance with a firm's prescribed quality control policies and procedures and, therefore, the effectiveness of the system.

.05 The system of quality control for a U.S. firm should provide the firm with reasonable assurance that the segments of the firm's engagements performed by its foreign offices or by its domestic or foreign affiliates or correspondents are performed in accordance with professional standards in the United States.³

Establishment of Quality Control Policies and Procedures

.06 The nature and extent of a firm's quality control policies and procedures depend on a number of factors, such as its size, the degree of operating autonomy allowed its personnel and its practice offices, the nature of its practice, its organization, and appropriate cost-benefit considerations.⁴

.07 A firm shall consider each of the elements of quality control discussed below, to the extent applicable to its practice, in establishing its quality control policies and procedures. The elements of quality control are interrelated. Thus, a firm's hiring practices affect its policies as to training. Training practices affect policies as to promotion. Practices in both categories affect policies as to supervision. Practices as to supervision, in turn, affect policies as to training and promotion.

a. Independence. Policies and procedures should be established to provide the firm with reasonable assurance that persons at all organizational levels maintain independence to the extent required by the rules of conduct of the AICPA. Rule 101 [ET section 101.01] of the rules of conduct contains examples of instances wherein a firm's independence will be considered to be impaired.

b. Assigning Personnel to Engagements. Policies and procedures for assigning personnel to engagements should be established to provide the firm with reasonable assurance that work will be performed by persons having the degree of technical training and proficiency required in the circumstances. In making assignments, the nature and extent of supervision to be provided should be taken into account. Generally, the more able and experienced the personnel assigned to a particular engagement, the less is the need for direct supervision.

³SAS No. 1, section 543 [AU section 543], provides guidance regarding procedures to be considered on individual audit engagements when the principal auditor utilizes the work of other auditors.

⁴*Quality Control Policies and Procedures for CPA Firms* [section 90], may be useful to a firm in considering its quality control policies and procedures.

c. Consultation. Policies and procedures for consultation should be established to provide the firm with reasonable assurance that personnel will seek assistance, to the extent required, from persons having appropriate levels of knowledge, competence, judgment, and authority. The nature of the arrangements for consultation will depend on a number of factors, including the size of the firm and the levels of knowledge, competence, and judgment possessed by the persons performing the work.

d. Supervision. Policies and procedures for the conduct and supervision of work at all organizational levels should be established to provide the firm with reasonable assurance that the work performed meets the firm's standards of quality. The extent of supervision and review appropriate in a given instance depends on many factors, including the complexity of the subject matter, the qualifications of the persons performing the work, and the extent of consultation available and used. The responsibility of a firm for establishing procedures for supervision is distinct from the responsibility of individuals to adequately plan and supervise the work on a particular engagement.

e. Hiring. Policies and procedures for hiring should be established to provide the firm with reasonable assurance that those employed possess the appropriate characteristics to enable them to perform competently. The quality of a firm's work ultimately depends on the integrity, competence, and motivation of personnel who perform and supervise the work. Thus, a firm's recruiting programs are factors in maintaining such quality.

f. Professional Development. Policies and procedures for professional development should be established to provide the firm with reasonable assurance that personnel will have the knowledge required to enable them to fulfill responsibilities assigned. Continuing professional education and training activities enable a firm to provide personnel with the knowledge required to fulfill responsibilities assigned to them and to progress within the firm.

g. Advancement. Policies and procedures for advancing personnel should be established to provide the firm with reasonable assurance that those selected for advancement will have the qualifications necessary for fulfillment of the responsibilities they will be called on to assume. Practices in advancing personnel have important implications for the quality of a firm's work. Qualifications that personnel selected for advancement should possess include, but are not limited to, character, intelligence, judgment, and motivation.

h. Acceptance and Continuance of Clients. Policies and procedures should be established for deciding whether to accept or continue a client in order to minimize the likelihood of association with a client whose management lacks integrity. Suggesting that there should be procedures for this purpose does not imply that a firm vouches for the integrity or reliability of a client, nor does it imply that a firm has a duty to anyone but itself with respect to the acceptance, rejection, or retention of clients. However, prudence suggests that a firm be selective in determining its professional relationships.

i. Inspection. Policies and procedures for inspection should be established to provide the firm with reasonable assurance that the procedures relating to the other elements of quality control are being effectively applied. Procedures for inspection may be developed and performed by individuals acting on behalf of the firm's management. The type of

inspection procedures used will depend on the controls established by the firm and the assignment of responsibilities within the firm to implement its quality control policies and procedures.

Assignment of Responsibilities

.08 A firm shall assign responsibilities to its personnel to the extent required to effectively implement its quality control policies and procedures. In the assignment of responsibilities, appropriate consideration should be given to the competence of the individuals, the authority delegated to them, and the extent of supervision provided.

Communication

.09 A firm shall communicate to its personnel its quality control policies and procedures in a manner that will provide reasonable assurance that such policies and procedures are understood. The form and extent of such communication should be sufficiently comprehensive to provide the firm's personnel with information concerning the quality control policies and procedures applicable to them. Although communication ordinarily is enhanced if the communication is in writing, the effectiveness of a firm's system of quality control is not necessarily impaired by the absence of documentation of established quality control policies and procedures. The size, structure, and nature of practice of the firm should be considered in determining whether documentation of quality control policies and procedures is required and, if so, the extent of such documentation. Normally, documentation of quality control policies and procedures would be expected to be more extensive in a larger firm than in a smaller firm and more extensive in a multi-office firm than in a single-office firm.

Monitoring

.10 A firm shall monitor the effectiveness of its system of quality control by evaluating on a timely basis its quality control policies and procedures, assignment of responsibilities, and communication of policies and procedures. The size, structure, and nature of practice of a firm influence both the requirements and the limitations of its monitoring function. Implicit in the monitoring function is timely modification of policies and procedures, assignment of responsibilities, and the form and extent of communication, as required by new authoritative pronouncements or by other changes in circumstances, including those resulting from expansion of practice or opening of offices, merging of firms, or acquiring of practices. Monitoring activities include, but are not limited to, the quality control element of inspection.

[The next page is 17,021.]

QC Section 10-1

System of Quality Control for a CPA Firm: Interpretations of QC Section 10

Interpretations of Quality Control Standards are issued by the Quality Control Standards Committee, the senior technical committee of the Institute designated to issue pronouncements on Quality Control Standards. Interpretations do not have the authority of Statements on Quality Control Standards issued by the AICPA Quality Control Standards Committee. However, members of the AICPA and member firms of the Division for CPA Firms should be aware that they may be called upon to justify departures from interpretations.

1. The Relationship Between Inspection and Monitoring

.01 Question. What is the relationship between inspection and monitoring?

.02 Interpretation. The objective of monitoring is to determine on a timely basis that the firm's quality control policies and procedures, assignment of responsibilities, and communication of policies and procedures continue to be appropriate. The objective of inspection is to determine compliance with quality control policies and procedures in effect during a period of time. Inspection procedures contribute to the monitoring function because findings, which may indicate the need to modify quality control policies or procedures, are evaluated and changes are considered. Other events such as new authoritative pronouncements or other changes in circumstances, including those resulting from expansion of practice or opening of offices, mergers of firms, acquiring of practices, or separations of significant portions of a firm or its key personnel, may also indicate a need for change in quality control policies and procedures.

[Issue Date: July, 1980.]

2. Implementation of Inspection in CPA Firms

.03 Statement on Quality Control Standards No. 1 [section 10] indicates that "policies and procedures for inspection should be established to provide the firm with reasonable assurance that the procedures relating to the other elements of quality control are being effectively applied. Procedures for inspection may be developed and performed by individuals acting on behalf of the firm's management. The type of inspection procedures used will depend on the controls established by the firm and the assignment of responsibilities within the firm to implement its quality control policies and procedures." Additionally, the guide *Quality Control Policies and Procedures for CPA Firms—Establishing Quality Control Policies and Procedures* [section 90] offers examples of how to implement quality control policies and procedures for the element of inspection.

.04 Question. How is inspection implemented?

.05 Interpretation. Inspection is implemented by performing the following at least each year:

- Review administrative and personnel files to determine whether there is reasonable assurance that the firm's quality control policies and procedures are being complied with.
- Review engagement working papers, files, and reports to determine whether there is reasonable assurance that the firm's quality control policies and procedures and professional standards are being complied with.

.06 Inspection procedures should be applied to the extent necessary to provide the firm with reasonable assurance that its quality control policies and procedures are being complied with. Thus, inspection procedures should be applied to each element of quality control and may be on a test basis.

.07 The performance of inspection procedures may result in information useful in performing the monitoring function.

.08 Inspection findings should be considered by appropriate firm management personnel. The firm should implement appropriate action as a result of inspection findings and should follow up to determine that planned actions were taken.

.09 A firm's inspection policies and procedures may provide that a peer review conducted under the AICPA Division for CPA Firms fulfills the firm's annual inspection requirements for the year covered by the peer review. However, standards for performing peer reviews issued by the SEC and Private Companies Practice Sections of the AICPA Division for CPA Firms provide that the scope of the peer review may be affected by the review team's evaluation of the scope and adequacy of the firm's inspection program.

.10 *Question.* Does the element of inspection apply to all CPA firms including sole practitioners, with or without professional staff?

.11 *Interpretation.* The element of inspection applies to all CPA firms, including sole practitioners with or without professional staff.

.12 *Question.* How can inspection be implemented in sole practitioner CPA firms?

.13 *Interpretation.* Statement on Quality Control Standards No. 1 [section 10] indicates that the type of inspection procedures used will depend on the controls established by the firm and the assignment of responsibilities within the firm to implement its quality control policies and procedures. It further indicates that procedures for inspection may be developed and performed by individuals acting on behalf of the firm's management. Such individuals may be members of the sole practitioner's professional staff or be from outside the firm.

.14 A sole practitioner with or without professional staff may inspect his firm's compliance with his own policies and procedures. In performing such inspection procedures the practitioner may utilize checklists developed by the AICPA or other relevant materials.

.15 Alternatively, sole practitioner CPA firms with or without professional staff may engage a qualified individual or firm to perform inspection procedures. Two firms, including sole practitioners, may provide inspection procedures for one another.

.16 *Question.* How can inspection be implemented in other CPA firms that do not have internal personnel other than those responsible for the functional areas (elements of quality control) or engagements to perform inspection procedures?

.17 Interpretation. Such firms may employ the same procedures as set forth above [paragraphs .10-.15] for sole practitioners with or without professional staff.

.18 Question. Are there circumstances under which preissuance engagement review procedures may be considered part of the firm's inspection program?

.19 Interpretation. The engagement partner's review of working papers, files, and reports does not constitute inspection. However, if a firm uses the supervision procedure of a second management-level preissuance review of engagement working papers, files, and reports, such procedures may compensate for certain post issuance inspection procedures, and, therefore, could substitute for a part of the firm's inspection program. Such review should be the equivalent of the review the firm would have performed as an inspection procedure after issuance of the report to determine compliance with quality control policies and procedures and professional standards. Findings as a result of such reviews, since they should be equivalent to inspection findings, should be periodically summarized and considered by appropriate firm management personnel. The firm should implement appropriate action as a result of such findings and should follow up to determine that planned actions were taken. The firm would additionally need to review compliance with respect to each element of its quality control system at least each year.

[Issue Date: July, 1980.]

3. Documentation of Compliance with a System of Quality Control

.20 Question. In connection with the element of inspection, the Quality Control Standards Committee has been asked to clarify paragraph 7 (i) of Statement on Quality Control Standards No. 1 [section 10.07(i)] as to whether and to what extent documentation would ordinarily be required "to provide the firm with reasonable assurance that the procedures relating to the other elements of quality control are being effectively applied."

.21 Interpretation. Statement on Quality Control Standards No. 1 [section 10] states: "The nature and extent of a firm's quality control policies and procedures depend on a number of factors, such as its size, the degree of operating autonomy allowed its personnel and its practice offices, the nature of its practice, its organization, and appropriate cost-benefit considerations." Although Statement on Quality Control Standards No. 1 [section 10] does not specifically refer to documentation of compliance, a firm ordinarily should require the preparation and maintenance of appropriate documentation to demonstrate compliance with its policies and procedures for the elements of quality control discussed in Statement on Quality Control Standards No. 1 [section 10]. The form and extent of such documentation depend on a number of factors such as the size of a firm, the degree of operating autonomy allowed its personnel and its practice offices, the nature of its practice, its organization, and appropriate cost-benefit considerations. However, documentation should be sufficient to enable those conducting an inspection to ascertain the extent of a firm's compliance with its system of quality control, including its compliance with inspection policies and procedures.

[Issue Date: June, 1982.]

[The next page is 17,031.]

QC Section 20

System of Quality Control for a CPA Firm's Accounting and Auditing Practice

(Supersedes sections 10 and 10-1)*

Effective date: Applicable to a CPA firm's system of quality control for its accounting and auditing practice as of January 1, 1997.

Statements on Quality Control Standards are issued by the Auditing Standards Board. Firms that are enrolled in an Institute-approved practice-monitoring program are obligated to adhere to quality control standards established by the Institute.

Introduction and Applicability

.01 This section provides that a CPA firm shall have a system of quality control for its accounting and auditing practice and describes elements of quality control and other matters essential to the effective design, implementation, and maintenance of the system.

.02 The AICPA Principles of Professional Conduct provide, among other things, that "members should practice in firms that have in place internal quality-control procedures to ensure that services are competently delivered and adequately supervised."¹ Because of the public interest in the services provided by and the reliance placed on the objectivity and integrity of CPAs, this section provides that a CPA firm shall have a system of quality control for its accounting and auditing practice.²

System of Quality Control

.03 A firm³ has a responsibility to ensure its personnel⁴ comply with professional standards applicable to its accounting and auditing practice. A system of quality control is broadly defined as a process to provide the firm with reasonable assurance that its personnel comply with applicable professional standards and the firm's standards of quality. The policies and procedures designed to implement the system in one segment of a firm's practice may be the same as, different from, or interrelated with the policies and procedures designed for another segment, but the purpose of the system is the same for all segments of a firm's practice.

* This section will supersede QC sections 10 and 10-1 at its effective date.

¹ AICPA Code of Professional Conduct, "Article VI—Scope and Nature of Services" [ET section 57.03].

² *Accounting and auditing practice* refers to all audit, attest, accounting and review, and other services for which standards have been established by the AICPA Auditing Standards Board or the AICPA Accounting and Review Services Committee under rule 201 or 202 of the AICPA Code of Professional Conduct [ET sections 201 and 202]. Standards may also be established by other AICPA senior technical committees; engagements that are performed in accordance with those standards are not encompassed in the definition of an accounting and auditing practice.

³ A *firm* is defined in the AICPA Code of Professional Conduct as "a form of organization permitted by state law or regulation whose characteristics conform to resolutions of Council that is engaged in the practice of public accounting, including the individual owners thereof" [ET section 92.05].

⁴ The term *personnel* refers to all individuals who perform professional services for which the firm is responsible, whether or not they are CPAs.

.04 A firm's system of quality control encompasses the firm's organizational structure and the policies adopted and procedures established to provide the firm with reasonable assurance of complying with professional standards. The nature, extent, and formality of a firm's quality control policies and procedures should be appropriately comprehensive and suitably designed in relation to the firm's size, the number of its offices, the degree of authority allowed its personnel and its offices, the knowledge and experience of its personnel, the nature and complexity of the firm's practice, and appropriate cost-benefit considerations.

.05 Any system of quality control has inherent limitations that can reduce its effectiveness. Variance in an individual's performance and understanding of (a) professional requirements or (b) the firm's quality control policies and procedures affects the degree of compliance with a firm's prescribed quality control policies and procedures and, therefore, the effectiveness of the system.

.06 The system of quality control should provide the firm with reasonable assurance that the segments of the firm's engagements performed by its foreign offices or by its domestic or foreign affiliates or correspondents are performed in accordance with professional standards in the United States when such standards are applicable.

Quality Control Policies and Procedure

Elements of Quality Control

.07 The quality control policies and procedures applicable to a firm's accounting and auditing practice should encompass the following elements:

- a. *Independence, Integrity, and Objectivity*
- b. *Personnel Management*
- c. *Acceptance and Continuance of Clients and Engagements*
- d. *Engagement Performance*
- e. *Monitoring*

.08 The elements of quality control are interrelated. For example, the maintenance of *Integrity, Objectivity*, and, where required, *Independence* requires a continuing assessment of client relationships. Similarly, the element of *Personnel Management* encompasses criteria for professional development, hiring, advancement, and assignment of the firm's personnel to engagements, which affect policies and procedures developed to meet the objectives of the quality control element of *Engagement Performance*. Similarly, policies and procedures for the quality control element of *Monitoring* are established to provide the firm with reasonable assurance that the policies and procedures related to each of the other elements of quality control are suitably designed and are being effectively applied.

Independence, Integrity, and Objectivity

.09 Policies and procedures should be established to provide the firm with reasonable assurance that personnel maintain independence (in fact and in appearance) in all required circumstances,⁵ perform all professional responsibilities with integrity, and maintain objectivity in discharging professional responsibilities.

⁵ Independence requirements are set forth in Rule 101 of the AICPA Code of Professional Conduct [ET section 101] and the rules of applicable regulatory agencies such as state boards of accountancy, the Securities and Exchange Commission, the U.S. General Accounting Office, and the U.S. Department of Labor.

.10 *Independence, Integrity, and Objectivity* are defined and more fully described in the AICPA Code of Professional Conduct (the Code) and AU section 220, *Independence*. Rules 101 and 102 of the Code, and the related Interpretations and Rulings [ET sections 101, 102, and 191) contain examples of instances wherein a member's independence, integrity, and objectivity will be considered to be impaired. *Independence* encompasses an impartiality that recognizes an obligation for fairness not only to management and owners of a business but also to those who may otherwise use the firm's report. The firm and its personnel must be free from any obligation to or interest in the client, its management, or its owners.⁶ *Integrity* requires personnel to be honest and candid within the constraints of client confidentiality. Service and the public trust should not be subordinated to personal gain and advantage. *Objectivity* is a state of mind and a quality that lends value to a firm's services. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest.

Personnel Management

.11 A firm's quality control system depends heavily on the proficiency of its personnel. In making assignments, the nature and extent of supervision to be provided should be considered. Generally, the more able and experienced the personnel assigned to a particular engagement, the less direct supervision is needed.

.12 The quality of a firm's work ultimately depends on the integrity, objectivity, intelligence, competence, experience, and motivation of personnel who perform, supervise, and review the work. Thus, a firm's personnel management policies and procedures factor into maintaining such quality.

.13 *Personnel Management* encompasses hiring, assigning personnel to engagements, professional development, and advancement activities. Accordingly, policies and procedures should be established to provide the firm with reasonable assurance that—

- a. Those hired possess the appropriate characteristics to enable them to perform competently.
- b. Work is assigned to personnel having the degree of technical training and proficiency required in the circumstances.
- c. Personnel participate in general and industry-specific continuing professional education and other professional development activities that enable them to fulfill responsibilities assigned, and satisfy applicable continuing professional education requirements of the AICPA and regulatory agencies.⁷
- d. Personnel selected for advancement have the qualifications necessary for fulfillment of the responsibilities they will be called on to assume.

Acceptance and Continuance of Clients and Engagements

.14 Policies and procedures should be established for deciding whether to accept or continue a client relationship and whether to perform a specific engagement for that client. Such policies and procedures should provide the firm with reasonable assurance that the likelihood of association with a client whose management lacks integrity is minimized. Establishing such policies

⁶ See AU section 220.02.

⁷ Regulatory agencies that have established continuing education requirements include state boards of accountancy and the U.S. General Accounting Office.

and procedures does not imply that a firm vouches for the integrity or reliability of a client, nor does it imply that a firm has a duty to any person or entity but itself with respect to the acceptance, rejection, or retention of clients. However, prudence suggests that a firm be selective in determining its client relationships and the professional services it will provide.

.15 Such policies and procedures should also provide reasonable assurance that the firm—

- a. Undertakes only those engagements that the firm can reasonably expect to be completed with professional competence.
- b. Appropriately considers the risks associated with providing professional services in the particular circumstances.

.16 To minimize the risk of misunderstandings regarding the nature, scope, and limitations of the services to be performed, policies and procedures should provide for obtaining an understanding with the client regarding those services. Professional standards may provide guidance in deciding whether the understanding should be oral or written.

Engagement Performance

.17 Policies and procedures should be established to provide the firm with reasonable assurance that the work performed by engagement personnel meets applicable professional standards, regulatory requirements, and the firm's standards of quality.

.18 Policies and procedures for *Engagement Performance* encompass all phases of the design and execution of the engagement. To the extent appropriate and as required by applicable professional standards, these policies and procedures should cover planning, performing, supervising, reviewing, documenting, and communicating the results of each engagement.

.19 Policies and procedures should also be established to provide reasonable assurance that personnel refer to authoritative literature or other sources and consult, on a timely basis, with individuals within or outside the firm, when appropriate (for example, when dealing with complex, unusual, or unfamiliar issues). Individuals consulted should have appropriate levels of knowledge, competence, judgment, and authority. The nature of the arrangements for consultation depends on a number of factors, including the size of the firm and the levels of knowledge, competence, and judgment possessed by the persons performing the work.

Monitoring

.20 Policies and procedures should be established to provide the firm with reasonable assurance that the policies and procedures established by the firm for each of the other elements of quality control described in paragraphs .07 through .19 are suitably designed and are being effectively applied.⁸ *Monitoring* involves an ongoing consideration and evaluation of the—

- a. Relevance and adequacy of the firm's policies and procedures.
- b. Appropriateness of the firm's guidance materials and any practice aids.
- c. Effectiveness of professional development activities.
- d. Compliance with the firm's policies and procedures. When monitoring, the effects of the firm's management philosophy and the envi-

⁸ See section 30, *Monitoring a CPA Firm's Accounting and Auditing Practice*.

ronment in which the firm practices and its clients operate should be considered.

Administration of a Quality Control System

.21 To provide reasonable assurance that the firm's quality control system achieves its objectives, appropriate consideration should be given to the assignment of quality control responsibilities within the firm, the means by which quality control policies and procedures are communicated, and the extent to which the policies and procedures and compliance therewith should be documented.

Assignment of Responsibilities

.22 Responsibility for the *design* and *maintenance* of the various quality control policies and procedures should be assigned to an appropriate individual or individuals in the firm. In making that assignment, consideration should be given to the proficiency of the individuals, the authority to be delegated to them, and the extent of supervision to be provided. However, all of the firm's personnel are responsible for *complying* with the firm's quality control policies and procedures.

Communication

.23 A firm should communicate its quality control policies and procedures to its personnel in a manner that provides reasonable assurance that those policies and procedures are understood and complied with. The form and extent of such communications should be sufficiently comprehensive to provide the firm's personnel with an understanding of the quality control policies and procedures applicable to them. In addition, a firm should establish a means of communicating its established quality control policies and procedures, and the changes thereto, to appropriate personnel on a timely basis.

Documentation of Quality Control Policies and Procedures

.24 The size, structure, and nature of the practice of the firm should be considered in determining whether documentation of established quality control policies and procedures is required for effective communication and, if so, the extent of such documentation. For example, documentation of established quality control policies and procedures would generally be expected to be more extensive in a large firm than in a small firm and in a multioffice firm than in a single-office firm. Although communication ordinarily is enhanced if it is in writing, the effectiveness of a firm's system of quality control is not necessarily impaired by the absence of documentation of established quality control policies and procedures.

Documentation of Compliance With Quality Control Policies and Procedures

.25 A firm should prepare appropriate documentation to demonstrate *compliance* with its policies and procedures for the quality control system discussed herein. The form and content of such documentation is a matter of judgment and depends on a number of factors, such as the size of a firm, the number of offices, the degree of authority allowed its personnel and its offices, the nature and complexity of the firm's practice, its organization, and appropriate cost-benefit considerations. Documentation should be retained for a period of time sufficient to enable those performing monitoring procedures and a peer review to evaluate the extent of the firm's compliance with its quality control policies and procedures.

Effective Date

.26 The provisions of this section are applicable to a CPA firm's system of quality control for its accounting and auditing practice as of January 1, 1997.

[The next page is 17,041.]

QC Section 30

Monitoring a CPA Firm's Accounting and Auditing Practice

Effective date: Applicable to a CPA firm's system of quality control for its accounting and auditing practice as of January 1, 1997.

Statements on Quality Control Standards are issued by the Auditing Standards Board. Firms that are enrolled in an Institute-approved practice-monitoring program are obligated to adhere to quality control standards established by the Institute.

Introduction

.01 This section provides guidance on how a CPA firm implements the monitoring element of a quality control system in its accounting and auditing practice.¹

.02 Section 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, describes *Monitoring* as one of the five elements of quality control. It provides that a CPA firm² should establish policies and procedures to provide the firm with reasonable assurance that the policies and procedures relating to each of the other elements of quality control are suitably designed and are being effectively applied. Monitoring involves an ongoing consideration and evaluation of the—

- a. Relevance and adequacy of the firm's policies and procedures.
- b. Appropriateness of the firm's guidance materials and any practice aids.
- c. Effectiveness of professional development activities.
- d. Compliance with the firm's policies and procedures.

When monitoring, the effects of the firm's management philosophy and the environment in which the firm practices and its clients operate should be considered.

Monitoring Procedures

.03 Monitoring procedures taken as a whole should enable the firm to obtain reasonable assurance that its system of quality control is effective. Procedures that provide the firm with a means of identifying and communicating circumstances that may necessitate changes to or the need to improve compliance with the firm's policies and procedures contribute to the monitoring element. A firm's monitoring procedures may include—

¹ *Accounting and auditing practice* refers to all audit, attest, accounting and review, and other services for which standards have been established by the AICPA Auditing Standards Board or the AICPA Accounting and Review Services Committee under rule 201 or 202 of the AICPA Code of Professional Conduct [ET sections 201 and 202]. Standards may also be established by other AICPA senior technical committees; engagements that are performed in accordance with those standards are not encompassed in the definition of an accounting and auditing practice.

² A *firm* is defined in the AICPA Code of Professional Conduct as "a form of organization permitted by state law or regulation whose characteristics conform to resolutions of Council that is engaged in the practice of public accounting, including the individual owners thereof" [ET section 92.05].

- Inspection procedures. (See paragraphs .04 through .07.)
- Preissuance or postissuance review of selected engagements. (See paragraphs .08 and .09.)
- Analysis and assessment of—
 - New professional pronouncements.
 - Results of independence confirmations.
 - Continuing professional education and other professional development activities undertaken by firm personnel.³
 - Decisions related to acceptance and continuance of client relationships and engagements.
 - Interviews of firm personnel.
- Determination of any corrective actions to be taken and improvements to be made in the quality control system.
- Communication to appropriate firm personnel of any weaknesses identified in the quality control system or in the level of understanding or compliance therewith.
- Follow-up by appropriate firm personnel to ensure that any necessary modifications are made to the quality control policies and procedures on a timely basis.

.04 Inspection procedures evaluate the adequacy of the firm's quality control policies and procedures, its personnel's understanding of those policies and procedures, and the extent of the firm's compliance with its quality control policies and procedures. Inspection procedures contribute to the monitoring function because findings are evaluated and changes in or clarifications of quality control policies and procedures are considered.

.05 The need for and extent of inspection procedures depends in part on the existence and effectiveness of the other monitoring procedures. Factors to be considered in determining the need for and extent of inspection procedures include, but are not limited to—

- The nature, complexity, and diversity of, and the risks associated with, the firm's practice.
- The firm's size, number of offices, degree of authority allowed its personnel and its offices, and organizational structure.
- The results of recent practice reviews⁴ and previous inspection procedures.
- Appropriate cost-benefit considerations.⁵

.06 The nature of inspection procedures will vary based on the firm's quality control policies and procedures and the effectiveness and results of other monitoring procedures. The adequacy of and compliance with a firm's quality control system are evaluated by performing such inspection procedures as—

- Review of selected administrative and personnel records pertaining to the quality control elements.

³ The term *personnel* refers to all individuals who perform professional services for which the firm is responsible, whether or not they are CPAs.

⁴ Practice reviews include, but are not limited to, peer reviews performed under standards established by the AICPA and reviews conducted by regulatory agencies.

⁵ Although appropriate cost-benefit considerations may be considered in determining the need for and extent of inspection procedures, a firm must still effectively *monitor* its practice.

- Review of engagement working papers, reports, and clients' financial statements. (See also paragraphs .08 and .09.)
- Discussions with the firm's personnel.
- Summarization of the findings from the inspection procedures, at least annually, and consideration of the systemic causes of findings that indicate improvements are needed.
- Determination of any corrective actions to be taken or improvements to be made with respect to the specific engagements reviewed or the firm's quality control policies and procedures.
- Communication of the identified findings to appropriate firm management personnel.
- Consideration of inspection findings by appropriate firm management personnel who should also determine that any actions necessary, including necessary modifications to the quality control system, are taken on a timely basis.

Inspection procedures with respect to the engagement performance element of a quality control system are particularly appropriate in a firm with more than a limited number of management-level individuals⁶ responsible for the conduct of its accounting and auditing practice.

.07 Inspection procedures may be performed at a fixed time(s) during the year covering a specified period(s) of time or as part of ongoing quality control procedures, or a combination thereof.

.08 Procedures for carrying out preissuance or postissuance review of engagement working papers, reports, and clients' financial statements by a qualified management-level individual (or by a qualified individual under his or her supervision) may be considered part of the firm's monitoring procedures provided that those performing or supervising such preissuance or postissuance reviews are *not directly associated with the performance of the engagement*. Such preissuance or postissuance review procedures may constitute inspection procedures provided—

- a. The review is sufficiently comprehensive to enable the firm to assess compliance with all applicable professional standards and the firm's quality control policies and procedures.
- b. Findings of such reviews that may indicate the need to improve compliance with or modify the firm's quality control policies and procedures are periodically summarized, documented, and communicated to the firm's management personnel having the responsibility and authority to make changes in those policies and procedures.
- c. The firm's management personnel consider on a timely basis the systemic causes of findings that indicate improvements are needed and determine appropriate actions to be taken.
- d. The firm implements on a timely basis such planned actions, communicates changes to personnel who might be affected, and follows up to determine that the planned actions were taken.

A preissuance and, except as described in paragraph .09, a postissuance review of engagement working papers, reports, and clients' financial statements by

⁶ The term *management-level individual* refers to all owners of a firm and other individuals within the firm with a managerial position as described in Interpretation 101-9 of the Code of Professional Conduct [ET section 101.11].

the person with final responsibility for the engagement does not constitute a monitoring procedure.

.09 In small firms with a limited number of qualified management-level individuals, postissuance review of engagement working papers, reports, and clients' financial statements by the person with final responsibility for the engagement may constitute inspection procedures, provided the provisions in paragraph .08a–d are followed. (See also paragraph .11.)

Monitoring in Small Firms With a Limited Number of Management-Level Individuals

.10 In small firms with a limited number of management-level individuals, monitoring procedures may need to be performed by some of the same individuals who are responsible for compliance with the firm's quality control policies and procedures. To effectively monitor one's own compliance with the firm's policies and procedures, an individual must be able to critically review his or her own performance, assess his or her own strengths and weaknesses, and maintain an attitude of continual improvement. Changes in conditions and in the environment within the firm (such as obtaining clients in an industry not previously serviced or significantly changing the size of the firm) may indicate the need to have quality control policies and procedures monitored by another qualified individual.

.11 The performance of inspection procedures in firms with a limited number of management-level individuals can assist the firm in the monitoring process. An individual inspecting his or her own compliance with a quality control system may be inherently less effective than having such compliance inspected by another qualified individual. When one individual inspects his or her own compliance, the firm may have a higher risk that noncompliance with policies and procedures will not be detected. Accordingly, a firm in this circumstance may find it beneficial to engage a qualified individual from outside the firm to perform inspection procedures.

The Relationship of Peer Review to Monitoring

.12 A peer review does not substitute for monitoring procedures. However, since the objective of a peer review is similar to that of inspection procedures, a firm's quality control policies and procedures may provide that a peer review conducted under standards established by the AICPA may substitute for some or all of its inspection procedures for the period covered by the peer review.

Effective Date

.13 The provisions of this section are applicable to a CPA firm's system of quality control for its accounting and auditing practice as of January 1, 1997.

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QC Section

QUALITY CONTROL POLICIES AND PROCEDURES FOR CPA FIRMS

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NOTICE TO READERS

This guide is being issued by the AICPA Quality Control Standards Committee to provide guidance for the application in practice of Statement on Quality Control Standards 1. It does not have the authority of a pronouncement by the AICPA Quality Control Standards Committee. However, members of the AICPA and member firms of the division for CPA firms should be aware that they may be called upon to justify departures from the guide.

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QC Section 90

Establishing Quality Control Policies and Procedures

Introduction

.01 A system of quality control for a CPA firm, as described in Statement on Quality Control Standards 1 [section 10], encompasses quality control policies and procedures, assignment of responsibilities, communication, and monitoring. This guide provides guidance for the establishment of quality control policies and procedures in accordance with paragraphs 6 and 7 of Statement on Quality Control Standards 1 [section 10.06—.07], *System of Quality Control for a CPA Firm*.

.02 Those paragraphs provide that the nature and extent of a firm's quality control policies and procedures depend on a number of factors, such as its size, the degree of operating autonomy allowed its personnel and its practice offices, the nature of its practice, its organization, and appropriate cost-benefit considerations.

.03 A firm shall consider each of the elements of quality control, to the extent applicable to its practice, in establishing its quality control policies and procedures. Certain of the elements of quality control are interrelated. Thus, a firm's hiring practices affect its policies as to training. Training practices affect policies as to promotion. Practices in both categories affect policies as to supervision. Practices as to supervision, in turn, affect policies as to training and promotion.

.04 The terms *firm*, *professional standards*, and *personnel*, as used in this guide, are defined in Statement on Quality Control Standards 1 [section 10]. The term *policies* refers to a CPA firm's objectives and goals for effecting the elements of quality control. *Procedures* refers to the steps to be taken to accomplish the policies adopted.

.05 The elements of quality control are identified in Statement on Quality Control Standards 1 [section 10] and are discussed in this document under the following designations:

- Independence
- Assigning Personnel to Engagements
- Consultation
- Supervision
- Hiring
- Professional Development
- Advancement
- Acceptance and Continuance of Clients
- Inspection

.06 A firm should consider establishing policies in the areas identified under each element of quality control discussed herein to the extent such policies are applicable to its practice. Illustrative examples of procedures designed to implement the policies adopted are also presented. The specific procedures used by a firm would not necessarily include all those illustrated or be limited to them.

.07 Some regulatory agencies have promulgated requirements for compliance with independence or other standards that are applicable to professionals practicing before them. Therefore, a firm should adopt policies and procedures to provide reasonable assurance of compliance with the requirements of the regulatory agencies before which it practices.

.08 When firms merge or when a firm acquires a practice, the combined firm should give special attention to quality control considerations. The combined firm's quality control policies and procedures should be evaluated to determine that they continue to be applicable in light of the changed circumstances. Similar attention should be given to quality control considerations when a firm is divided.

Independence

.09 Policies and procedures should be established to provide the firm with reasonable assurance that persons at all organizational levels maintain independence to the extent required by the rules of conduct of the AICPA. Rule 101 [ET section 101.01] of the rules of conduct contains examples of instances wherein a firm's independence will be considered to be impaired.

Policies and Procedures

.10 A firm should give consideration to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

- 1. Require that personnel at all organizational levels adhere to the independence rules, regulations, interpretations, and rulings of the AICPA, state CPA society, state board of accountancy, state statute, and, if applicable, the Securities and Exchange Commission and other regulatory agencies.¹**
 - a. Designate an individual or group to provide guidance and to resolve questions on independence matters.
 - (i) Identify circumstances where documentation of the resolution of questions would be appropriate.

¹ In some cases, a firm may wish to establish other requirements that it deems appropriate, for example, concerning prohibited transactions or relationships.

- (ii) Require consultation with authoritative sources when considered necessary.
- 2. Communicate policies and procedures relating to independence to personnel at all organizational levels.**
- a. Inform personnel of the firm's independence policies and procedures and advise them that they are expected to be familiar with these policies and procedures.
 - b. Emphasize independence of mental attitude in training programs and in supervision and review of engagements.
 - c. Apprise personnel on a timely basis of those entities to which independence policies apply.
 - (i) Prepare and maintain for independence purposes a list of the firm's clients and of other entities (client's affiliates, parents, associates, and so forth) to which independence policies apply.
 - (ii) Make the list available to personnel (including personnel new to the firm or to an office) who need it to determine their independence.
 - (iii) Establish procedures to notify personnel of changes in the list.
 - d. Maintain a library or other facility containing professional, regulatory, and firm literature relating to independence matters.
- 3. Confirm, when acting as principle auditor, the independence of another firm engaged to perform segments of an engagement.²**
- a. Inform personnel about the form and content of an independence representation that is to be obtained from a firm that has been engaged to perform segments of an engagement.
 - b. Advise personnel about the frequency with which a representation should be obtained from an affiliate or associate firm for a repeat engagement.
- 4. Monitor compliance with policies and procedures relating to independence.**
- a. Obtain from personnel periodic, written representations, normally on an annual basis, stating that—
 - (i) They are familiar with the firm's independence policies and procedures.
 - (ii) Prohibited investments are not held and were not held during the period. As an alternative or additional procedure, a firm may obtain listings of investments and securities transactions (numbers of shares or dollar amounts need not be included) from personnel to determine that there are no prohibited holdings.

² If a firm utilizes the services of a related, affiliated, or associated firm, the principal firm may obtain periodically (frequently annually) a representation from the other firm covering all referred engagements or may include the representation as part of a continuing agreement.

If a firm other than an affiliate or associate is retained, representation should be received for each engagement.

In the case of an international engagement, the representation from the foreign firm should make reference to U. S. independence standards.

- (iii) Prohibited relationships do not exist, and transactions prohibited by firm policy have not occurred.
- b. Assign responsibility for resolving exceptions to a person or group with appropriate authority.
- c. Assign responsibility for obtaining representations and reviewing independence compliance files for completeness to a person or group with appropriate authority.
- d. Review periodically accounts receivable from clients to ascertain whether any outstanding amounts take on some of the characteristics of loans and may, therefore, impair the firm's independence.

Assigning Personnel to Engagements

.11 Policies and procedures for assigning personnel to engagements should be established to provide the firm with reasonable assurance that work will be performed by persons having the degree of technical training and proficiency required in the circumstances. In making assignments, the nature and extent of supervision to be provided should be taken into account. Generally, the more able and experienced the personnel assigned to a particular engagement, the less is the need for direct supervision.

Policies and Procedures

.12 A firm should give consideration to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

1. **Delineate the firm's approach to assigning personnel, including the planning of overall firm and office needs and the measures employed to achieve a balance of engagement manpower requirements, personnel skills, individual development, and utilization.**
 - a. Plan the personnel needs of the firm on an overall basis and for individual practice offices.
 - b. Identify on a timely basis the staffing requirements of specific engagements.
 - c. Prepare time budgets for engagements to determine manpower requirements and to schedule field work.
 - d. Consider the following factors in achieving a balance of engagement manpower requirements, personnel skills, individual development, and utilization:
 - (i) Engagement size and complexity.

- (ii) Personnel availability.
 - (iii) Special expertise required.
 - (iv) Timing of the work to be performed.
 - (v) Continuity and periodic rotation of personnel.
 - (vi) Opportunities for on-the-job training.
2. Designate an appropriate person or persons to be responsible for assigning personnel to engagements.
- a. Consider the following in making assignments of individuals:
 - (i) Staffing and timing requirements of the specific engagement.
 - (ii) Evaluations of the qualifications of personnel regarding experience, position, background, and special expertise.
 - (iii) The planned supervision and involvement by supervisory personnel.
 - (iv) Projected time availability of individuals assigned.
 - (v) Situations where possible independence problems and conflicts of interest may exist, such as assignment of personnel to engagements for clients who are former employers or are employers of certain kin.
 - b. Give appropriate consideration, in assigning personnel, to both continuity and rotation to provide for efficient conduct of the engagement and the perspective of other personnel with different experience and backgrounds.
3. Provide for approval of the scheduling and staffing of the engagement by the person with final responsibility for the engagement.
- a. Submit, where necessary, for review and approval the names and qualifications of personnel to be assigned to an engagement.
 - b. Consider the experience and training of the engagement personnel in relation to the complexity or other requirements of the engagement and the extent of supervision to be provided.

Consultation

.13 Policies and procedures for consultation should be established to provide the firm with reasonable assurance that personnel will seek assistance, to the extent required, from persons having appropriate levels of knowledge, competence, judgment, and authority. The nature of arrangements for consultation will depend on a number of factors, including the size of the firm and the levels of knowledge, competence, and judgment possessed by the persons performing the work.

Policies and Procedures

.14 A firm should give consideration to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures

adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

1. **Identify areas and specialized situations where consultation is required, and encourage personnel to consult with or use authoritative sources on other complex or unusual matters.**
 - a. Inform personnel of the firm's consultation policies and procedures.
 - b. Specify areas or specialized situations requiring consultation because of the nature or complexity of the subject matter. Examples include—
 - (i) Application of newly issued technical pronouncements.
 - (ii) Industries with special accounting, auditing, or reporting requirements.
 - (iii) Emerging practice problems.
 - (iv) Choices among alternative generally accepted accounting principles when an accounting change is to be made.
 - (v) Filing requirements of regulatory agencies.
 - c. Maintain or provide access to adequate reference libraries and other authoritative sources.
 - (i) Establish responsibility for maintaining a reference library in each practice office.
 - (ii) Maintain technical manuals and issue technical pronouncements, including those relating to particular industries and other specialties.
 - (iii) Maintain consultation arrangements with other firms and individuals where necessary to supplement firm resources.
 - (iv) Refer problems to a division or group in the AICPA or state CPA society established to deal with technical inquiries.
 - d. Maintain a research function to assist personnel with practice problems.
2. **Designate individuals as specialists to serve as authoritative sources, and define their authority in consultative situations. Provide procedures for resolving differences of opinion between engagement personnel and specialists.**
 - a. Designate individuals as specialists for filings with the Securities and Exchange Commission and other regulatory agencies.
 - b. Designate specialists for particular industries.
 - c. Advise personnel of the degree of authority to be accorded specialists' opinions and of the procedures to be followed for resolving differences of opinion with specialists.
 - d. Require documentation of the considerations involved in the resolution of differences of opinion.
3. **Specify the extent of documentation to be provided for the results of consultation in those areas and specialized situations where consultation is required. Specify documentation, as appropriate, for other consultations.**

- a. Advise personnel about the extent of documentation to be prepared and the responsibility for its preparation.
- b. Indicate where consultation documentation is to be maintained.
- c. Maintain subject files containing the results of consultations for reference and research purposes.

Supervision

.15 Policies and procedures for the conduct and supervision of work at all organizational levels should be established to provide the firm with reasonable assurance that the work performed meets the firm's standards of quality. The extent of supervision and review appropriate in a given instance depends on many factors, including the complexity of the subject matter, the qualifications of the persons performing the work, and the extent of consultation available and used. The responsibility of a firm for establishing procedures for supervision is distinct from the responsibility of individuals to adequately plan and supervise the work on a particular engagement.

Policies and Procedures

.16 A firm should give consideration to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

1. Provide procedures for planning engagements.

- a. Assign responsibility for planning an engagement. Involve appropriate personnel assigned to the engagement in the planning process.
- b. Develop background information or review information obtained from prior engagements and update for changed circumstances.
- c. Describe matters to be included in the engagement planning process, such as the following:
 - (i) Development of proposed work programs.
 - (ii) Determination of manpower requirements and need for specialized knowledge.
 - (iii) Development of estimates of time required to complete the engagement.
 - (iv) Consideration of current economic conditions affecting the client or its industry and their potential impacts on the conduct of the engagement.

2. Provide procedures for maintaining the firm's standards of quality for the work performed.

- a. Provide adequate supervision at all organizational levels, considering the training, ability, and experience of the personnel assigned.

- b. Develop guidelines for the form and content of working papers.
 - c. Utilize standardized forms, checklists, and questionnaires to the extent appropriate to assist in the performance of engagements.
 - d. Provide procedures for resolving differences of professional judgment among members of an engagement team.
3. Provide procedures for reviewing engagement working papers and reports.
- a. Develop guidelines for review of working papers and for documentation of the review process.
 - (i) Require that reviewers have appropriate competence and responsibility.
 - (ii) Determine that work performed is complete and conforms to professional standards and firm policy.
 - (iii) Describe documentation evidencing review of working papers and the reviewer's findings. Documentation may include initialing working papers, completing a reviewer's questionnaire, preparing a reviewer's memorandum, and employing standard forms or checklists.
 - b. Develop guidelines for review of the report to be issued for an engagement. Considerations in *a*, above, would be applicable to this review. In addition, the following matters should be considered for these guidelines:
 - (i) Determine that the evidence of work performed and conclusions contained in the working papers support the report.
 - (ii) Determine that the report conforms to professional standards and firm policy.
 - (iii) Provide for review of the report by an appropriate individual having no other responsibility for the engagement.

Hiring

.17 Policies and procedures for hiring should be established to provide the firm with reasonable assurance that those employed possess the appropriate characteristics to enable them to perform competently. The quality of a firm's work ultimately depends on the integrity, competence, and motivation of personnel who perform and supervise the work. Thus, a firm's recruiting programs are factors in maintaining such quality.

Policies and Procedures

.18 A firm should give consideration to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

1. **Maintain a program designed to obtain qualified personnel by planning for personnel needs, establishing hiring objectives, and setting qualifications for those involved in the hiring function.**
 - a. Plan for the firm's personnel needs at all levels and establish quantified hiring objectives based on current clientele, anticipated growth, personnel turnover, individual advancement, and retirement.
 - b. Design a program to achieve hiring objectives which provides for—
 - (i) Identification of sources of potential hires.
 - (ii) Methods of contact with potential hires.
 - (iii) Methods of specific identification of potential hires.
 - (iv) Methods of attracting potential hires and informing them about the firm.
 - (v) Methods of evaluating and selecting potential hires for extension of employment offers.
 - c. Inform those persons involved in hiring about the firm's personnel needs and hiring objectives.
 - d. Assign to authorized persons the responsibility for employment decisions.
 - e. Monitor the effectiveness of the recruiting program.
 - (i) Evaluate the recruiting program periodically to determine whether policies and procedures for obtaining qualified personnel are being observed.
 - (ii) Review hiring results periodically to determine whether goals and personnel needs are being achieved.
2. **Establish qualifications and guidelines for evaluating potential hires at each professional level.**
 - a. Identify the attributes to be sought in hires, such as intelligence, integrity, honesty, motivation, and aptitude for the profession.
 - b. Identify achievements and experiences desirable for entry-level and experienced personnel; for example—
 - (i) Academic background.
 - (ii) Personal achievements.
 - (iii) Work experience.
 - (iv) Personal interests.
 - c. Set guidelines to be followed when hiring individuals in atypical situations, such as—
 - (i) Hiring relatives of personnel or relatives of clients.
 - (ii) Rehiring former employees.
 - (iii) Hiring client employees.
 - d. Obtain background information and documentation of qualifications of applicants by appropriate means, such as—
 - (i) Resumes.
 - (ii) Application forms.

- (iii) Interviews.
 - (iv) College transcripts.
 - (v) Personal references.
 - (vi) Former employment references.
- e Evaluate the qualifications of new personnel, including those obtained from other than the usual hiring channels (for example, those joining the firm at supervisory levels or through merger or acquisition), to determine that they meet the firm's requirements and standards.
- 3. Inform applicants and new personnel of the firm's policies and procedures relevant to them.**
- a. Use a brochure or another means to so inform applicants and new personnel.
 - b. Prepare and maintain a manual describing policies and procedures for distribution to personnel.
 - c. Conduct an orientation program for new personnel.

Professional Development

.19 Policies and procedures for professional development should be established to provide the firm with reasonable assurance that personnel will have the knowledge required to enable them to fulfill responsibilities assigned. Continuing professional education and training activities enable a firm to provide personnel with the knowledge required to fulfill responsibilities assigned to them and to progress within the firm.

Policies and Procedures

.20 A firm should give consideration to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

- 1. Establish guidelines and requirements for the firm's professional development program and communicate them to personnel.**
- a. Assign responsibility for the professional development function to a person or group with appropriate authority.
 - b. Provide that programs developed by the firm be reviewed by qualified individuals. Programs should contain statements of objectives and education and/or experience prerequisites.
 - c. Provide an orientation program relating to the firm and the profession for newly employed personnel.
 - (i) Prepare publications and programs designed to inform newly employed personnel of their professional responsibilities and opportunities.
 - (ii) Designate responsibility for conducting orientation conferences to explain professional responsibilities and firm policies.

- (iii) Enable newly employed personnel with limited experience to attend the AICPA or other comparable-level staff training programs.
 - d. Establish continuing professional education requirements for personnel at each level within the firm.
 - (i) Consider state mandatory requirements or voluntary guidelines in establishing firm requirements.
 - (ii) Encourage participation in external continuing professional education programs, including college-level and self-study courses.
 - (iii) Encourage membership in professional organizations. Consider having the firm pay or contribute toward membership dues and expenses.
 - (iv) Encourage personnel to serve on professional committees, prepare articles, and participate in other professional activities.
 - e. Monitor continuing professional education programs and maintain appropriate records, on both a firm and an individual basis.
 - (i) Review periodically the records of participation by personnel to determine compliance with firm requirements.
 - (ii) Review periodically evaluation reports and other records prepared for continuing education programs to evaluate whether the programs are being presented effectively and are accomplishing firm objectives. Consider the need for new programs and for revision or elimination of ineffective programs.
- 2. Make available to personnel information about current developments in professional technical standards and materials containing the firm's technical policies and procedures and encourage personnel to engage in self-development activities.**
 - a. Provide personnel with professional literature relating to current developments in professional technical standards.
 - (i) Distribute to personnel material of general interest, such as pronouncements of the Financial Accounting Standards Board and the AICPA Auditing Standards Board.
 - (ii) Distribute pronouncements in areas of specific interest, such as those issued by the Securities and Exchange Commission, Internal Revenue Service, and other regulatory agencies to persons who have responsibility in such areas.
 - (iii) Distribute manuals containing firm policies and procedures on technical matters to personnel. Manuals should be updated for new developments and changing conditions.
 - b. For training programs presented by the firm, develop or obtain course materials and select and train instructors.
 - (i) State the program objectives and education and/or experience prerequisites in the training programs.

- (ii) Provide that program instructors be qualified in both program content and teaching methods.
 - (iii) Have participants evaluate program content and instructors of training sessions.
 - (iv) Have instructors evaluate program content and participants in training sessions.
 - (v) Update programs as needed in light of new developments, changing conditions, and evaluation reports.
3. Provide, to the extent necessary, programs to fill the firm's needs for personnel with expertise in specialized areas and industries.
- a. Conduct firm programs to develop and maintain expertise in specialized areas and industries, such as regulated industries, computer auditing, and statistical sampling methods.
 - b. Encourage attendance at external education programs, meetings, and conferences to acquire technical or industry expertise.
 - c. Encourage membership and participation in organizations concerned with specialized areas and industries.
 - d. Provide technical literature relating to specialized areas and industries.
4. Provide for on-the-job training during the performance of engagements.
- a. Emphasize the importance of on-the-job training as a significant part of an individual's development.
 - (i) Discuss with assistants the relationship of the work they are performing to the engagement as a whole.
 - (ii) Involve assistants in as many portions of the engagement as practicable.
 - b. Emphasize the significance of personnel management skills and include coverage of these subjects in firm training programs.
 - c. Encourage personnel to train and develop subordinates.
 - d. Monitor assignments to determine that personnel—
 - (i) Fulfill, where applicable, the experience requirements of the state board of accountancy.
 - (ii) Gain experience in various areas of engagements and varied industries.
 - (iii) Work under different supervisory personnel.

Advancement

.21 Policies and procedures for advancing personnel should be established to provide the firm with reasonable assurance that those selected for advancement will have the qualifications necessary for fulfillment of the responsibilities they will be called on to assume. Practices in advancing personnel have important implications for the quality of a firm's work. Qualifications that personnel selected for advancement should possess include, but are not limited to, character, intelligence, judgment, and motivation.

Policies and Procedures

.22 A firm should give consideration to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

- 1. Establish qualifications deemed necessary for the various levels of responsibility within the firm.**
 - a. Prepare guidelines describing responsibilities at each level and expected performance and qualifications necessary for advancement to each level, including—
 - (i) Titles and related responsibilities.
 - (ii) The amount of experience (which may be expressed as a time period) generally required for advancement to the succeeding level.
 - b. Identify criteria that will be considered in evaluating individual performance and expected proficiency, such as the following:
 - (i) Technical knowledge.
 - (ii) Analytical and judgmental abilities.
 - (iii) Communicative skills.
 - (iv) Leadership and training skills.
 - (v) Client relations.
 - (vi) Personal attitude and professional bearing (character, intelligence, judgment, and motivation).
 - (vii) Possession of a CPA certificate for advancement to a supervisory position.
 - c. Use a personnel manual or other means to communicate advancement policies and procedures to personnel.
- 2. Evaluate performance of personnel, and periodically advise personnel of their progress. Maintain personnel files containing documentation relating to the evaluation process.**
 - a. Gather and evaluate information on performance of personnel.
 - (i) Identify evaluation responsibilities and requirements at each level indicating who will prepare evaluations and when they will be prepared.
 - (ii) Instruct personnel on the objectives of personnel evaluation.
 - (iii) Utilize forms, which may be standardized, for evaluating performance of personnel.
 - (iv) Review evaluations with the individual being evaluated.
 - (v) Require that evaluations be reviewed by the evaluator's superior.
 - (vi) Review evaluations to determine that individuals worked for and were evaluated by different persons.
 - (vii) Determine that evaluations are completed on a timely basis.

- b. Periodically counsel personnel regarding their progress and career opportunities.
 - (i) Review periodically with personnel the evaluation of their performance, including an assessment of their progress with the firm. Considerations should include the following:
 - (a) Performance.
 - (b) Future objectives of the firm and the individual.
 - (c) Assignment preferences.
 - (d) Career opportunities.
 - (ii) Evaluate partners periodically by means of counseling, peer evaluation, or self appraisal, as appropriate, regarding whether they continue to have the qualifications to fulfill their responsibilities.
 - (iii) Review periodically the system of personnel evaluation and counseling to ascertain that—
 - (a) Procedures for evaluation and documentation are being followed on a timely basis.
 - (b) Requirements established for advancement are being achieved.
 - (c) Personnel decisions are consistent with evaluations.
 - (d) Recognition is given to outstanding performance.

3. Assign responsibility for making advancement decisions.

- a. Assign responsibility to designated persons for making advancement and termination decisions, conducting evaluation interviews with persons considered for advancement, documenting the results of the interviews, and maintaining appropriate records.
- b. Evaluate data obtained giving appropriate recognition in advancement decisions to the quality of the work performed.
- c. Study the firm's advancement experience periodically to ascertain whether individuals meeting stated criteria are assigned increased degrees of responsibility.

Acceptance and Continuance of Clients

.23 Policies and procedures should be established for deciding whether to accept or continue a client in order to minimize the likelihood of association with a client whose management lacks integrity. Suggesting that there should be procedures for this purpose does not imply that a firm vouches for the integrity or reliability of a client, nor does it imply that a firm has a duty to anyone but itself with respect to the acceptance, rejection, or retention of clients. However, prudence suggests that a firm be selective in determining its professional relationships.

Policies and Procedures

.24 A firm should give consideration to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed

to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

1. Establish procedures for evaluation of prospective clients and for their approval as clients.

- a. Consider evaluation procedures such as the following before accepting a client:
 - (i) Obtain and review available financial information regarding the prospective client, such as annual reports, interim financial statements, registration statements, Forms 10-K, other reports to regulatory agencies, and income tax returns.
 - (ii) Inquire of third parties about any information regarding the prospective client and its management and principals that may have a bearing on evaluating the prospective client. Inquiries may be directed to the prospective client's bankers, legal counsel, investment banker, underwriter, and others in the financial or business community who may have such knowledge. Credit reports may also be useful.
 - (iii) Communicate with the predecessor auditor as required by auditing standards. Inquiries should include questions regarding facts that might bear on the integrity of management, on disagreements with management regarding accounting principles, auditing procedures, or other similarly significant matters, and on the predecessor's understanding of the reasons for the change of auditors.
 - (iv) Consider circumstances that would cause the firm to regard the engagement as one requiring special attention or presenting unusual risks.
 - (v) Evaluate the firm's independence and ability to service the prospective client. In evaluating the firm's ability, consider needs for technical skills, knowledge of the industry, and personnel.
 - (vi) Determine that acceptance of the client would not violate applicable regulatory agency requirements and the codes of professional ethics of the AICPA or a state CPA society.
- b. Designate an individual or group, at appropriate management levels, to evaluate the information obtained regarding the prospective client and to make the acceptance decision.
 - (i) Consider types of engagements that the firm would not accept or that would be accepted only under certain conditions.
 - (ii) Provide for documentation of the conclusion reached.
- c. Inform appropriate personnel of the firm's policies and procedures for accepting clients.
- d. Designate responsibility for administering and monitoring compliance with the firm's policies and procedures for acceptance of clients.

2. Evaluate clients at the end of specific periods or upon the occurrence of specified events to determine whether the relationships should be continued.
 - a. Specify conditions that require evaluation of a client to determine whether the relationship should be continued. Conditions could include—
 - (i) Expiration of a time period.
 - (ii) Significant change since the last evaluation, including a major change in one or more of the following:
 - (a) Management.
 - (b) Directors.
 - (c) Ownership.
 - (d) Legal counsel.
 - (e) Financial condition.
 - (f) Litigation status.
 - (g) Nature of the client's business.
 - (h) Scope of the engagement.
 - (iii) The existence of conditions that would have caused the firm to reject a client had such conditions existed at the time of the initial acceptance.
 - b. Designate an individual or group, at appropriate management levels, to evaluate the information obtained and to make continuance decisions.
 - (i) Consider types of engagements that the firm would not continue or that would be continued only under certain conditions.
 - (ii) Provide for documentation of the conclusion reached.
 - c. Inform appropriate personnel of the firm's policies and procedures for continuing clients.
 - d. Designate responsibility for administering and monitoring compliance with the firm's policies and procedures for continuance of clients.

Inspection

.25 Policies and procedures for inspection should be established to provide the firm with reasonable assurance that the procedures relating to the other elements of quality control are being effectively applied. Procedures for inspection may be developed and performed by individuals acting on behalf of the firm's management. The type of inspection procedures used will depend on the controls established by the firm and the assignment of responsibilities within the firm to implement its quality control policies and procedures.

Policies and Procedures

.26 A firm should give consideration to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to

its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

1. Define the scope and content of the firm's inspection program.

- a. Determine the inspection procedures necessary to provide reasonable assurance that the firm's other quality control policies and procedures are operating effectively.
 - (i) Determine objectives and prepare instructions and review programs for use in conducting inspection activities.
 - (ii) Provide guidelines for the extent of work at practice units, functions, or departments, and criteria for selection of engagements for review.
 - (iii) Establish the frequency and timing of inspection activities.
 - (iv) Establish procedures to resolve disagreements that may arise between reviewers and engagement or management personnel.
- b. Establish qualifications for personnel to participate in inspection activities and the method of their selection.
 - (i) Determine criteria for selecting reviewers, including levels of responsibility in the firm and requirements for specialized knowledge.
 - (ii) Assign responsibility for selecting inspection personnel.
- c. Conduct inspection activities at practice units, functions, or departments.
 - (i) Review and test compliance with applicable quality control policies and procedures.
 - (ii) Review selected engagements for compliance with professional standards, including generally accepted auditing standards, generally accepted accounting principles, and with the firm's quality control policies and procedures.

2. Provide for reporting inspection findings to the appropriate management levels and for monitoring actions taken or planned.

- a. Discuss inspection review findings on engagements reviewed with engagement management personnel.
- b. Discuss inspection findings of practice units, functions, or departments reviewed with appropriate management personnel.
- c. Report inspection findings and recommendations to firm management together with corrective actions taken or planned.
- d. Determine that planned corrective actions were taken.

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