Establishing and maintaining a system of quality control for a CPA firm’s accounting and auditing practice

American Institute of Certified Public Accountants. Joint Task Force on Quality Control Standards

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Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice
Notice to Readers

This AICPA Audit and Accounting Practice Aid supersedes *Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm’s Accounting and Auditing Practice* (guide), which was issued in 1996. This Practice Aid is intended to help practitioners better understand and apply the Statements on Quality Control Standards (SQCSs) issued by the American Institute of Certified Public Accountants. Those standards are included in Appendix B of this Practice Aid. This version of the guide, prepared by the Quality Control Standards Task Force (task force), has been revised to incorporate new policies and procedures that a firm should consider including in its system of quality control to be responsive to the changing environment. The policies and procedures presented in this Practice Aid are illustrative, and firms are encouraged to consider them in designing and maintaining a system of quality control that is appropriate for their accounting and auditing practices. Some of the policies and procedures presented in this Practice Aid are not explicitly required by the SQCSs; however, they represent the views of the task force regarding best practices for a quality control system. Although this Practice Aid has been reviewed by the AICPA Audit and Attest Standards staff, it has not been approved, disapproved, or otherwise acted upon by any senior technical committee of the AICPA and has no official or authoritative status.

On July 30, 2002, President Bush signed the Sarbanes-Oxley Act of 2002 (Act) which created a five-member Public Company Accounting Oversight Board (PCAOB) and charged it with overseeing audits of issuers, as defined by the Act. Under the Act, the PCAOB’s duties include, among other things, establishing auditing, quality control, ethics, independence, and other standards relating to audits of issuers.

This Practice Aid does not address the quality control ramifications of the Act nor does it address the quality control ramifications of PCAOB standards that must be followed by auditors of issuers. Auditors of issuers should become familiar with the provisions of these other standards and make changes to their firm’s quality control systems as necessary. Auditors of nonissuers who are engaged to report on audit engagements in accordance with PCAOB auditing standards also must report on those engagements in accordance with generally accepted auditing standards (GAAS). Interpretation No. 17, “Clarification in the Audit Report of the Extent of Testing of Internal Control Over Financial Reporting in Accordance With Generally Accepted Auditing Standards,” and Interpretation No. 18, “Reference to PCAOB Standards in an Audit Report on a Nonissuer,” of SAS No. 58, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU secs. 9508.85-.88 and 9508.89-.92, respectively) provide reporting guidance for audits of nonissuers when the auditor is asked to report in accordance with GAAS and PCAOB auditing standards.

As previously stated, this Practice Aid does not purport to include any modifications that may be necessary for a firm’s system of quality control to conform to PCAOB standards. Additional information about the PCAOB and the Act can be obtained at the PCAOB Web site: http://www.pcaobus.org and the AICPA Web site: http://www.aicpa.org/info/Sarbanes-Oxley2002.asp.

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1 Paragraph 7 of Section 2, “Definitions,” of the Sarbanes-Oxley Act of 2002 states, “The term ‘issuer’ means an issuer (as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c)), the securities of which are registered under section 12 of that Act (15 U.S.C. 78l), or that is required to file reports under section 15(d) (15 U.S.C. 78o(d)), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a et seq.), and that it has not withdrawn.”
Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice

Prepared by
a Task Force of the
American Institute of Certified Public Accountants

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<thead>
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<tbody>
<tr>
<td>Craig W. Crawford, <strong>Chair</strong></td>
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<tr>
<td>Robert E. Fleming</td>
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<td>James W. Goad</td>
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<td>John W. Gribble</td>
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<td>Suzanne M. Heidenreich</td>
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<tr>
<td>Anthony D. Lynn</td>
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<td>Scott McDonald</td>
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<td>Daniel D. Montgomery</td>
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<td>Paul Murman</td>
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<td>Edmund R. Noonan</td>
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<td>Mark K. Scoles</td>
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**AICPA Staff**

<table>
<thead>
<tr>
<th>Name</th>
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<tbody>
<tr>
<td>Charles E. Landes</td>
<td><strong>Director</strong></td>
</tr>
<tr>
<td><strong>Audit and Attest Standards</strong></td>
<td></td>
</tr>
<tr>
<td>Judith M. Sherinsky</td>
<td><strong>Technical Manager</strong></td>
</tr>
<tr>
<td><strong>Audit and Attest Standards</strong></td>
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CHAPTER 1: OVERVIEW OF STATEMENTS ON QUALITY CONTROL STANDARDS

1.01 A system of quality control is a process that encompasses the firm’s organizational structure and the policies and procedures it establishes. The nature, extent, and formality of a firm’s quality control policies and procedures should be sufficiently 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.

1.02 The objective of a system of quality control is to provide a CPA firm with reasonable assurance that its personnel comply with applicable professional standards and the firm’s standards of quality. Statements on Quality Control Standards (SQCSs), which are issued by the Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants (AICPA), consist of the following three standards:

a. SQCS No. 2, System of Quality Control for a CPA Firm’s Accounting and Auditing Practice (AICPA, Professional Standards, vol. 2, QC sec. 20), as amended. This standard:
   - Defines the term quality control
   - Describes the elements of quality control
   - Establishes the requirement for a CPA firm to have a system of quality control for its accounting and auditing practice
   - Provides guidance on how to design, implement, and maintain a system of quality control

b. SQCS No. 3, Monitoring a CPA Firm’s Accounting and Auditing Practice (AICPA, Professional Standards, vol. 2, QC sec. 30). This standard provides guidance on how a CPA firm implements the monitoring element of a quality control system.


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1 Terms defined in Appendix A, “Glossary of Selected Terms,” are in boldface type the first time they appear.
2 The term reasonable assurance is used because absolute assurance cannot be attained. Statement on Quality Control Standards (SQCS) No. 2, System of Quality Control for a CPA Firm’s Accounting and Auditing Practice (AICPA, Professional Standards, vol. 2, QC sec. 20.05), as amended, states, “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.”
charge should have or obtain. SQCS No. 5 (QC sec. 40.04), defines competencies as the knowledge, skills, and abilities that enable a practitioner-in-charge to be qualified to perform an accounting, auditing, or attestation engagement.

1.03 A firm should establish a system of quality control that includes policies and procedures that address each of the following five elements of quality control identified in SQCS No. 2.

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

1.04 The elements of quality control are interrelated. For example, for a firm to maintain independence, integrity, and objectivity, it must continually assess client relationships that affect policies and procedures related to the acceptance and continuance of clients and engagements. Similarly, the personnel management element of quality control encompasses criteria related to professional development, hiring, advancement, and assignment of firm personnel to engagements, which all affect policies and procedures related to engagement performance. In addition, policies and procedures related to the monitoring element of quality control enable a firm to evaluate whether its policies and procedures for each of the other four elements of quality control are suitably designed and effectively applied.

1.05 If a firm merges, acquires, sells, or otherwise changes a portion of its practice, the surviving firm should evaluate and, as necessary, revise, implement, and maintain firm-wide quality control policies and procedures that are appropriate for the changed circumstances.

**INDEPENDENCE, INTEGRITY, AND OBJECTIVITY**

1.06 The objective of the independence, integrity, and objectivity element of a system of quality control is to provide the firm with reasonable assurance that personnel maintain independence (in fact and in appearance) in all required circumstances, perform all professional responsibilities with integrity, and maintain objectivity in discharging professional responsibilities. Establishing and maintaining policies such as the following ordinarily would satisfy this objective:

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3 SQCS No. 5, The Personnel Management Element of a Firm’s System of Quality Control—Competencies Required by a Practitioner-in-Charge of an Attest Engagement (AICPA, Professional Standards, vol. 2, QC sec. 40.03), defines a practitioner-in-charge as an individual who is responsible for supervising accounting, auditing, and attestation engagements and signing or authorizing an individual to sign the accountant’s report on such engagements.
• Requiring that personnel adhere to applicable independence, integrity, and objectivity requirements such as those in regulations, interpretations, and rules of the AICPA, state CPA societies, state boards of accountancy, state statutes, the U.S. Government Accountability Office (GAO; formerly the General Accounting Office) and any other applicable regulators.

• Having the firm’s senior management set a tone for the organization that stresses the importance of ethical values, especially as they pertain to accounting and auditing engagements, and communicating related policies and procedures to firm personnel.

• Establishing procedures to help mitigate possible threats to independence and objectivity.

• Establishing procedures for confirming the independence of another firm or firm personnel in associated member firms who perform part of the engagement. This would apply to national firm personnel and foreign firm personnel, including foreign-associated firms.¹

**Personnel Management**

1.07 The objective of the personnel management element of a system of quality control is to provide the firm with reasonable assurance that all personnel have the competencies to perform their assigned responsibilities. Attributes or qualities that enhance the competencies of personnel who perform, supervise, or review work include integrity, objectivity, intelligence, judgment, competence, experience, and motivation. This objective ordinarily would be satisfied by establishing and maintaining policies such as the following:

• Hiring personnel who possess the characteristics that enable them to perform competently.

• Assigning personnel who have the knowledge, skills, and abilities required in the circumstances. In making assignments, the nature and extent of supervision to be provided should be considered. Generally, the more qualified and experienced the personnel assigned to a particular engagement, the less direct supervision needed; the less qualified and less experienced the personnel assigned to a particular engagement, the more direct supervision needed.

• Having personnel participate in general and industry-specific continuing professional education and professional development activities that should enable them to accomplish assigned responsibilities and satisfy applicable continuing professional education requirements of the AICPA, state boards of accountancy, and other regulators.

• Selecting for advancement only those individuals who have the qualifications necessary to accomplish the responsibilities they will be called on to assume.

• Compensating partners and senior-level employees in a manner that provides an incentive and reward for quality work and for maintaining independence, integrity, and objectivity.

¹ A foreign-associated firm is a firm domiciled outside of the United States and its territories that is a member of, correspondent with, or similarly associated with an international firm or international association of firms.
Acceptance and Continuance of Clients and Engagements

1.08 The objective of the quality control element that addresses acceptance and continuance of clients and engagements is to establish criteria for deciding whether to accept or continue a client relationship and whether to perform a specific engagement for a client. A firm’s client acceptance and continuance policies represent a key element in mitigating litigation and business risk. Accordingly, a firm should be aware that the integrity and reputation of a client’s management could reflect on the reliability of the client’s accounting records and financial representations, and therefore on the firm’s reputation or involvement in litigation. A firm’s policies and procedures related to the acceptance and continuance of clients and engagements should provide the firm with reasonable assurance that:

- The likelihood of association with a client whose management lacks integrity is minimized.
- The firm undertakes only those engagements that can be completed with professional competence.
- The risks associated with providing professional services in particular circumstances are appropriately considered.
- An understanding is reached with the client regarding the services to be performed.

1.09 These objectives ordinarily should be satisfied for the initial period in which the firm is performing a service and for subsequent periods by establishing and maintaining policies such as the following.

- Evaluating factors that have a bearing on management’s integrity.
- Evaluating whether the engagement can be completed with professional competence, undertaking only those engagements that can be completed with professional competence, and appropriately considering the risk associated with providing professional services in particular circumstances.\(^5\)
- Obtaining an understanding with the client regarding the services to be performed.

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\(^5\) Such considerations would include the risk of providing professional services to significant clients or to other clients for which the practitioner’s objectivity or the appearance of independence may be impaired. In broad terms, the significance of a client to a member or a firm refers to relationships that could diminish a practitioner’s objectivity and independence in performing attest services. Examples of factors to consider in determining the significance of a client to an engagement partner, office, or practice unit include (a) the amount of time the partner, office, or practice unit devotes to the engagement, (b) the effect on the partner’s stature within the firm as a result of his or her service to the client, (c) the manner in which the partner, office, or practice unit is compensated, or (d) the effect that losing the client would have on the partner, office, or practice unit.
Engagement Performance

1.10 The objective of the engagement performance element of quality control is 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. Policies and procedures for engagement performance should address 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. Policies and procedures also should require personnel to refer to authoritative literature or other sources and to consult, on a timely basis, with individuals within or outside the firm, when appropriate. The objective of the engagement performance element of quality control ordinarily would be satisfied by establishing and maintaining policies such as the following:

- Requiring that all engagements be planned to meet professional, regulatory, and the firm’s requirements.
- Requiring that the work performed and the reports and other communications issued meet professional, regulatory, and the firm’s requirements.
- Establishing policies and procedures for the review of high-risk engagements.
- Identifying areas and specialized situations for which consultation is necessary and requiring personnel to refer to authoritative literature or other sources, or consult on a timely basis with individuals within or outside the firm, when appropriate, for example, when addressing complex, unusual, or unfamiliar issues.

Monitoring

1.11 The objective of the monitoring element of a system of quality control is to provide the firm with reasonable assurance that the policies and procedures related to the other elements of quality control are suitably designed and effectively applied. Monitoring involves an ongoing consideration and evaluation of a firm’s quality control policies and procedures, and the firm’s compliance therewith. A firm may satisfy this objective through ongoing inquiry, testing, and observation about such matters as:

- The relevancy and adequacy of the firm’s quality control policies and procedures in relation to the size of the firm.
- The appropriateness of the firm’s guidance materials and practice aids.
- The effectiveness of the firm’s professional development activities.
- The firm’s compliance with its policies and procedures, and with professional standards.
1.12 Monitoring the elements of quality control related to independence, integrity, and objectivity; personnel management; and acceptance and continuance of clients and engagements; involves an ongoing consideration from a firm-wide perspective of the matters listed in paragraph 1.11.

1.13 Monitoring of the engagement performance element of quality control may be performed through either preissuance or postissuance engagement review. A preissuance review is performed periodically on selected engagements throughout the year, prior to the firm’s release of its reports and the financial statements for these engagements. A postissuance review is performed during a designated period in the year on a sample of engagements for which the firm has already released its reports and the financial statements.

1.14 Both preissuance and postissuance review require a full review of the reports, financial statements, and workpapers to determine whether the firm has complied with its policies and procedures and professional standards. An example of evaluating engagement-level compliance with a firm’s quality control policies and procedures would be determining whether the documentation for a review of a Yellow-Book engagement indicates that the reviewer assessed whether the engagement staff had obtained the required CPE for such engagements.

**Applying the Quality Control Standards to Four Hypothetical Firms**

1.15 The remainder of the chapters in this Practice Aid present four different hypothetical firms and the quality control policies and procedures the firms implement to address each of the quality control elements. Following is a description of those firms and their characteristics.

- Multi-Office CPA Firm has 10 offices in 3 states and is centrally managed. It has approximately 35 partners, and 200 professionals. Its accounting and auditing practice has a concentration of financial-institution clients for which it performs audit and attest services. Multi-Office CPA Firm has no SEC clients. (Chapter 2)

- Single-Office CPA Firm has 1 office, 3 partners, and 10 professionals. Its accounting and auditing practice has a concentration of employee benefit plan audits. Single-Office CPA Firm has no SEC clients. (Chapter 3)

- Sole Practitioner, CPA, is a sole owner who has no professional staff and occasionally hires per diem professionals. Her accounting practice consists only of engagements subject to Statements on Standards for Accounting and Review Services (SSARSSs). (Chapter 4)

- An alternative practice structure is a nontraditional structure in the practice of public accounting consisting of an attest and a nonattest portion of the practice. The attest portion is conducted through a firm owned and controlled by CPAs. The nonattest portion is conducted through a separate entity, which may be an issuer or nonissuer, owned and controlled by individuals who are not CPAs. (Chapter 5)
The policies and procedures described in each chapter are those that a firm of a similar size and type should consider establishing and maintaining. The policies and procedures used by an actual firm need not necessarily include all those used by the illustrative firms nor be limited to those used by the illustrative firms.

1.16 Most firms will find it appropriate to communicate their policies and procedures in writing. Readers of this Practice Aid should assume that the quality control policies and procedures for the illustrative firms are in writing and distributed or made available electronically to all professional personnel.
CHAPTER 2: SYSTEM OF QUALITY CONTROL FOR A CPA FIRM’S ACCOUNTING AND AUDITING PRACTICE—FIRM WITH MULTIPLE OFFICES

2.01 This chapter describes how a CPA firm that has multiple offices and is centrally managed (Multi-Office CPA Firm) implements each element of quality control in its accounting and auditing practice. Multi-Office CPA Firm is a hypothetical firm that has 10 offices in 3 states and is centrally managed. Multi-Office CPA Firm has 35 partners, 200 professionals, and a concentration of financial-institution clients for which it performs audit and attest services. It has no Securities and Exchange Commission (SEC) clients.1

INDEPENDENCE, INTEGRITY, AND OBJECTIVITY

2.02 The objective of the independence, integrity, and objectivity element of a system of quality control is to provide the firm with reasonable assurance that personnel maintain independence (in fact and in appearance) in all required circumstances, perform all professional responsibilities with integrity, and maintain objectivity in discharging professional responsibilities. Multi-Office CPA Firm satisfies this objective by establishing and maintaining the policies and procedures described in paragraphs 2.03 to 2.06.

2.03 Policy 1: Personnel adhere to applicable independence, integrity, and objectivity requirements such as those in regulations, interpretations, and rules of the AICPA, state CPA societies, state boards of accountancy, state statutes, the U.S. Government Accountability Office2 (GAO), Department of Labor (DOL), Federal Deposit Insurance Corporation (FDIC), and any other applicable regulators. Multi-Office CPA Firm implements this policy by:

- For matters related to independence, integrity, and objectivity, designating one of its partners to be responsible for responding to questions, resolving matters, and determining the circumstances for which consultation with sources outside the firm may be required.
- Identifying circumstances for which documentation of the resolution of matters is appropriate.

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1 If Multi-Office CPA Firm were to be engaged to perform audit services for an issuer, it might need to revise its quality control policies and procedures to comply with Public Company Accounting Oversight Board (PCAOB) standards and to reflect Securities and Exchange Commission (SEC) requirements applicable to audits of issuers.

2 The U.S. Government Accountability Office was formerly known as the U.S. General Accounting Office.
• Maintaining a current list of (a) all entities with which firm personnel are prohibited from having a business relationship, and (b) all activities in which the firm is prohibited\(^3\) from engaging, as defined in the firm’s independence policies.

• Obtaining written representations from personnel, upon hire and on an annual basis, stating 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. (Such written representations should be accompanied by the most current list of all entities with which firm personnel are prohibited from having a business relationship.)

• Assigning responsibility to the firm’s quality-control partner for obtaining such written representations, reviewing independence compliance files for completeness, and resolving reported exceptions.

• Establishing 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.

• Designating a senior-level partner to be responsible for overseeing the adequate functioning of the firm’s independence policies.

• Implementing a system to identify investment holdings of partners and managers that might impair independence.

• Requiring all professionals to report, on a timely basis when identified, apparent violations of independence, integrity, or objectivity policies involving themselves, their spouses, or their dependents, and the corrective actions taken or proposed to be taken.

• Establishing a requirement for all professional personnel to notify the managing partner in each office of any potential activities that might impair independence or violate ethics rules, including services provided to entities with which firm personnel are prohibited from having a business relationship.

• Establishing a program that protects professional personnel who report potential ethics or independence violations to the proper parties in compliance with firm policy.

• Requiring the managing partner in each office, or a person designated by the managing partner, to periodically review unpaid fees from clients to ascertain whether any outstanding amounts impair the firm’s independence.

\(^3\) Examples of prohibited activities include providing certain valuation and information technology services to an audit client. Readers should refer to the rules of specific standard-setters to determine the extent and relevance of any prohibition.
Chapter 2: System of Quality Control for a CPA Firm’s Accounting and Auditing Practice—Firm With Multiple Offices

- Developing guidance that 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.

- Requiring all professional personnel to review the list of entities with which firm personnel are prohibited from having a business relationship before a professional or the spouse or dependent of a professional obtains a security or financial interest in an entity.

2.04 **Policy 2: The firm’s senior management sets a tone for the organization that stresses the importance of ethical values, especially as they pertain to accounting and auditing engagements, and communicates related policies and procedures to firm personnel.** Multi-Office CPA Firm implements this policy by:

- Having the managing partner (through e-mails, letters, recordings, and so on), emphasize the concepts of independence, integrity, and objectivity (including the significance of client engagements) in its professional development meetings, in the acceptance and continuance of clients and engagements, and in the performance of engagements. Because Multi-Office CPA Firm has a concentration of financial-institution clients, this also would include discussing the applicability of these concepts to engagements for financial institutions, such as the prohibition against any member of the engagement team having a loan with the institution, and the types of nonattest services that could affect independence.

- Providing each of its professional personnel with access to applicable professional and regulatory literature and advising them that they are expected to be familiar with that literature.

- Requiring periodic independence and ethics training for all professional personnel. Such training covers the firm’s independence and ethics policies and the independence and ethical requirements of all applicable regulators.

- Informing personnel on a timely basis of those entities to which independence policies apply, by:
  - Preparing and maintaining a list of entities with which firm personnel are prohibited from having a business relationship.
  - Making the list available to personnel so they may evaluate their independence (including personnel new to the firm or an office).
  - Notifying personnel on a timely basis of changes in the list.

4 In broad terms, the significance of a client to a member or a firm refers to relationships that could diminish a practitioner’s objectivity and independence in performing attest services. Examples of factors to consider in determining the significance of a client to an engagement partner, office, or practice unit include (a) the amount of time the partner, office, or practice unit devotes to the engagement, (b) the effect on the partner’s stature within the firm as a result of his or her service to the client, (c) the manner in which the partner, office, or practice unit is compensated, or (d) the effect that losing the client would have on the partner, office, or practice unit.
2.05 **Policy 3: The firm establishes procedures to help mitigate possible threats to independence and objectivity.** Multi-Office CPA Firm implements this policy by:

- Assigning a partner who is not otherwise associated with the engagement, or who practices in an office other than the office that performs the attest engagement, to review the engagement.
- Subjecting the assignment of engagement personnel to approval by another partner or manager.
- Periodically rotating engagement partners.
- Designing and implementing compensation systems that (a) reward partners and staff involved in the accounting and auditing practice for the quality of their work and their compliance with professional standards, and (b) provide disincentives for behavior, for example, the cross-selling of certain consulting services, that might be perceived as impairing the independence or objectivity of their work.
- Establishing additional procedures that provide safeguards when the firm performs audit or other attest work for (a) significant clients or (b) clients at which partners or other senior personnel are offered management positions, or accept offers of employment.

2.06 **Policy 4: The firm establishes procedures for confirming the independence of other firms, or firm personnel in associated member firms who are performing part of an engagement.** Multi-Office CPA Firm implements this policy by:

- Describing in its policies and procedures manual the form, content, and frequency of independence representations to be obtained.
- Requiring that such representations be documented.

**Personnel Management**

2.07 The objective of the personnel management element of a system of quality control is to provide the firm with reasonable assurance that all personnel have the appropriate characteristics to perform their assigned responsibilities competently. Attributes or qualities that enhance the competency of personnel who perform, supervise, or review work include integrity, objectivity, intelligence, judgment, experience, and motivation. Multi-Office CPA Firm satisfies this objective by establishing and maintaining the policies and procedures described in paragraphs 2.08 through 2.12.

2.08 **Policy 1: Personnel who are hired possess the characteristics that enable them to perform competently.** Multi-Office CPA Firm implements this policy by maintaining firm-wide hiring standards and evaluating the firm’s personnel needs, including:
• Designating a partner or other qualified individual in each office to be responsible for evaluating the overall personnel needs in that practice office and establishing hiring objectives based on factors such as existing clientele, anticipated growth, personnel turnover, and individual advancement.

• Developing and maintaining personnel policies and procedures that identify attributes, achievements, and experiences desired in entry-level and experienced personnel.

• Establishing criteria for evaluating personal characteristics such as integrity, competence, and motivation.

• Establishing guidelines for the additional procedures to be performed when hiring experienced personnel, such as performing background checks and inquiring about any outstanding regulatory actions.

• Preparing budgets that identify personnel needs at all levels.

• Identifying sources of employment candidates such as universities and executive recruiters.

• Selecting and training the individuals who will be interviewing candidates or otherwise participating in the hiring process.

• Summarizing and evaluating the results of the hiring process for each candidate, including approval of all hiring decisions.

2.09 Policy 2: The firm assigns personnel (including partners) based on the knowledge, skills, and abilities required in the circumstances and the nature and extent of supervision needed. Multi-Office CPA Firm implements this policy by:

• Specifying the competencies that the practitioners-in-charge of accounting, auditing, and attest engagements (or other person responsible for supervising and signing or authorizing someone to sign the firm’s report on such engagements) should possess. Such competencies include having an understanding of:

  — The role of the firm’s system of quality control and the Code of Professional Conduct, both of which play critical roles in assuring the integrity of the accounting, auditing, and attest function to users of reports.

  — The performance, supervision, and reporting aspects of the engagement, which ordinarily are gained through participation or training in similar engagements.

  — The industry in which the client operates, including its organization and operating characteristics, sufficient to identify areas of high or unusual risk associated with the engagement and to evaluate the reasonableness of industry-specific estimates.
— The professional standards applicable to the engagement being performed and to the indus-
— The skills that contribute to sound professional judgment, including the ability to exercise
— How the organization uses information technology, and the manner in which information
• Designating an appropriate person(s) in each office to be responsible for assigning personnel
• Establishing a policy for monitoring the continuation and rotation of engagement partners.

The individual who makes partner and manager assignments should be a partner, and in the case
of high-risk engagements or significant client engagements, second-level approval of such assign-
ments should be obtained, for example, from the industry partner or the quality assurance
partner.

2.10 Policy 3: Personnel participate in general and industry-specific continuing profes-
— Establishing guidelines for participation by personnel in professional development pro-
— Establishing guidelines for participation by personnel in professional development pro-
— Establishing guidelines for participation by personnel in professional development pro-
— Establishing guidelines for participation by personnel in professional development pro-
— Establishing guidelines for participation by personnel in professional development pro-

Multi-Office CPA Firm implements this policy by:

• Designating a partner to oversee the development of firm requirements and materials for a
professional development program covering subjects relevant to the firm’s clients and serv-
ices. Such responsibilities include:

— Establishing guidelines for participation by personnel in professional development pro-
grams, and considering the requirements of the AICPA, state boards of accountancy, and applicable regulators in establishing the firm’s CPE requirements.
— Maintaining appropriate documentation evidencing that personnel have met the professional education requirements of the firm, the AICPA, state boards of accountancy, and other applicable regulators.

— Providing an orientation program and training for new personnel to inform them of their professional responsibilities and firm policies.

— Preparing and providing publications and programs to inform personnel of their responsibilities and opportunities.

— Developing in-house staff training programs that focus on general and industry-specific accounting and auditing subjects, including audits of financial institutions.

• Communicating and distributing to personnel changes in accounting, auditing, attestation, and quality control standards, as well as independence, integrity, and objectivity requirements.

• Encouraging professional personnel at each level in the firm to participate in external professional development activities such as:

— Continuing professional education courses
— Meetings of professional organizations
— Serving on professional committees
— Writing for professional publications
— Speaking to professional groups

2.11 **Policy 4: Only those individuals who have the qualifications necessary to accomplish the responsibilities they will be called on to assume are selected for advancement.** Multi-Office CPA Firm implements this policy by:

• Appointing a director of human resources to identify and communicate, in the firm’s policies and procedures manual, the qualifications necessary to accomplish responsibilities at each professional level in the firm. This includes:

— Establishing criteria for evaluating personnel at each professional level and for advancing to the next higher level of responsibility. Such criteria give due recognition and reward to the development and maintenance of competence and commitment to ethical principles.

— Developing evaluation forms for each professional-staff classification, including partners. Such forms include evaluation of performance quality and adherence to ethical principals.

— Informing personnel that failure to adhere to the firm’s policies and procedures regarding performance quality and commitment to ethical principles may result in disciplinary action.
• Assigning responsibility to a partner for making advancement and termination decisions for staff, and recommendations to the firm’s management committee for manager and partner-level advancement and termination. Such responsibilities include:
  — Identifying responsibilities and requirements for evaluation at each level and indicating who will prepare these evaluations and when they will be prepared.
  — Reviewing evaluations on a timely basis with the individual being evaluated.

• Advising personnel regarding their progress and career opportunities by:
  — At least annually, summarizing and reviewing with personnel their performance evaluations, including assessing their progress with the firm. Considerations should include past performance, future objectives of the firm and the individual, assignment preferences, and career opportunities.
  — Periodically evaluating partners by means of performance reviews, peer evaluations, or self-appraisals, as appropriate, to determine whether they continue to have the qualifications to accomplish their assigned responsibilities and to assume additional responsibilities.

2.12 **Policy 5: Partners and senior-level employees are compensated in a manner that provides an incentive and reward for quality work and for maintaining independence, integrity, and objectivity.** Multi-Office CPA Firm implements this policy by:

• Establishing a compensation system that predominantly rewards accounting and auditing partners and senior-level employees for the quality of their accounting and auditing work. The compensation system:
  — Takes into consideration firm feedback based on concurring reviews, internal inspections, and outside reviews of the work performed.
  — Rewards partners and personnel for timely identifying significant and emerging accounting and auditing issues and for timely seeking consultation with firm experts.
  — Does not include any material rewards for the cross-selling of services.

**Acceptance and Continuance of Clients and Engagements**

2.13 The objective of the acceptance and continuance of clients and engagements element of a system of quality control is to establish criteria for deciding whether to accept or continue a client relationship and whether to perform a specific engagement for a 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.
• The firm undertakes only those engagements it can reasonably expect to complete with professional competence.

• The risks associated with providing professional services in particular circumstances are appropriately considered.

• An understanding with the client regarding the services to be performed is reached.

Multi-Office CPA Firm satisfies this objective, both with respect to the initial period for which the firm is performing its service and for subsequent periods, by establishing and maintaining the policies and procedures described in paragraphs 2.14 through 2.16.

2.14 Policy 1: The firm evaluates factors that have a bearing on management’s integrity. Multi-Office CPA Firm implements this policy by:

• Developing and maintaining a manual that contains policies and procedures related to the acceptance of prospective clients and the continuance of existing clients. 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.

• Advising professional personnel that they are expected to be familiar with the firm’s policies and procedures for the acceptance and continuance of clients.

• Obtaining and evaluating applicable information before accepting or continuing any client. The following are examples of such information:

  — Information regarding the client and its operations from sources such as annual reports, interim financial statements, reports to regulators, enforcement actions by regulators, and income tax returns.

  — Management’s understanding of the nature and purpose of the services to be provided.

  — Information obtained from inquiries of third parties about the client, its management, and principals that may have a bearing on evaluating the client. Examples of such third parties are bankers, legal counsel, investment bankers, underwriters, and other members of the financial or business community who may have applicable knowledge. Inquiries also might be made regarding management’s attitude toward compliance with regulators or legislative requirements and the presence of reportable conditions, especially those that management is unwilling to correct.

  • Communicating with the predecessor accountant or auditor when required or suggested by professional standards. This communication also includes inquiries regarding the nature of any disagreements, and whether there is evidence of opinion-shopping.

  • Assessing management’s commitment to implementing and maintaining effective internal control.
• Assessing management’s commitment to the appropriate application of generally accepted accounting principles.

If the firm is unable to obtain sufficient information about the prospective client after completing the steps listed above, or there is an indication that management or someone affiliated with the prospective client may be less than reputable, the firm conducts a background check of the business, its officers, and the person(s) in question by using an investigative firm and evaluates the information obtained regarding management’s integrity.

2.15 **Policy 2: The firm (a) evaluates whether the engagement can be completed with professional competence, (b) undertakes only those engagements that can be completed with professional competence, and (c) appropriately considers the risk associated with providing professional services in particular circumstances.** Multi-Office CPA Firm implements this policy by:

• Evaluating whether the practice office has obtained or can reasonably expect to obtain the knowledge and expertise necessary to perform the engagement, for example, through the resources of another practice office.

• Defining high-risk engagements.

• Specifying conditions that trigger the requirement between annual audits to reevaluate a client or engagement. The following are examples of such conditions.
  
  — Significant changes in the client, for example, 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, for example, an initial public offering or a request to step down from an audit to a review engagement.
  
  — Changes in the composition or strategic focus of the firm, for example, the inability to replace the loss of key personnel who are particularly knowledgeable about a specialized industry, or a decision by the CPA firm to discontinue services to clients in a particular industry.
  
  — The existence of conditions that would have caused the firm to reject the engagement had such conditions existed at the time of the initial acceptance, for example, aggressive earnings management, unreliable processes for developing accounting estimates, questionable estimates by management, questions regarding the entity’s ability to continue as a going concern, and other factors that may increase the risk of being associated with the client.
  
  — The client’s delinquency in paying fees. (This may also affect the firm’s independence.)

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5 Such considerations would include the risk of providing professional services to significant clients or to other clients for which the practitioner’s objectivity or the appearance of independence may be impaired.
— Engagements for entities operating in highly specialized or regulated industries, such as financial institutions, governmental entities, and employee benefit plans.

— Engagements for entities in the development stage.

- Obtaining relevant information to determine whether the relationship should be continued and establishing the frequency with which client continuance evaluations should be made.

- Evaluating the information obtained regarding acceptance or continuance of a client or engagement. The evaluation process includes the following steps:
  
  — All information obtained about the client or the specific engagement is evaluated by the engagement partner, including information about the significance of the client to the firm,\(^6\) and a recommendation is made as to whether the client or engagement should be accepted or continued.

  — The engagement partner completes a client acceptance form and submits it to the managing partner of the practice office for approval.

  — The engagement partner signs a step in the planning program noting that he or she has considered whether the client should be continued, and if conditions exist that trigger the requirement between annual audits to reevaluate a client or engagement, prepares a form documenting his or her rationale and conclusion regarding client continuance.

  — The partner responsible for the quality control function evaluates and approves the recommendation made by the engagement partner. In certain defined circumstances, such as high-risk engagements, acceptance or continuance decisions also may require approval of the firm’s managing partner.

2.16 **Policy 3: The firm establishes an understanding with the client regarding the services to be performed.** Multi-Office CPA Firm implements this policy by requiring that for all engagements, the firm prepare a written engagement letter documenting the understanding with the client, and obtain the client’s signature on that letter, thus minimizing the risk of misunderstandings regarding the nature, scope, and limitations of the services to be performed.

### Engagement Performance

2.17 The objective of the engagement performance element of a system of quality control is 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. 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 profes-

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\(^6\) See footnote 4.
sional standards, these policies and procedures should cover planning, performing, supervising, reviewing, documenting, and communicating the results of each engagement. Policies and procedures also should require 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 addressing complex, unusual, or unfamiliar issues). Multi-Office CPA Firm satisfies this objective by establishing and maintaining the policies and procedures described in paragraphs 2.18 to 2.21.

2.18 **Policy 1: Planning for engagements meets professional, regulatory, and the firm’s requirements.** Multi-Office CPA Firm implements this policy by developing, maintaining, and providing personnel with the firm’s policies and procedures manual which delineates the factors the engagement team should consider in the planning process, and the extent of documentation of these considerations. Planning considerations may vary depending on the size and complexity of the engagement. Planning generally includes:

- Assigning responsibility to the engagement partner for planning the engagement and assigning responsibilities to appropriate personnel during the planning phase.
- Developing or updating background information about the client.
- Considering client significance to the firm.
- For all initial audit clients designated as high risk by the firm, establishing a requirement for an independent review of planning considerations.
- Requiring planning documentation that includes:
  - Proposed work programs tailored to the specific engagement.
  - Staffing requirements, including the need for personnel with specialized knowledge who may have to be obtained from other practice offices.
  - Consideration of the economic conditions affecting the client and its industry, and its potential effect on the conduct of the engagement.
  - Consideration of risks and how they may affect the procedures to be performed.
  - A budget that allocates a sufficient amount of time for the engagement to be performed in accordance with professional standards and the firm’s quality control policies and procedures.
  - Evidence of review of planning by an independent review partner.

2.19 **Policy 2: The engagement is performed, supervised, reviewed, documented, and reported (or communicated) in accordance with the requirements of professional standards, applicable regulators, and the firm.** Multi-Office CPA Firm implements this policy by:
• Providing personnel with the firm’s policies and procedures manual which:
  — Prescribes the form and content of documentation of the work performed and conclusions reached, including forms, checklists, and questionnaires to be used in performing engagements.
  — Prescribes the form in which instructions are to be given to other offices or other auditors performing part of an engagement, and the extent to which such work is to be reviewed and documented.
  — Specifies the extent of overall engagement review required, at all professional levels, to ensure that the financial statements meet professional and firm presentation and disclosure requirements.
  — Specifies the extent of review to be performed of required communications to management and the board of directors.

• Assigning responsibility for the review of all reports, financial statements, and documentation of the work performed and conclusions reached to a reviewer senior to the preparer in accordance with procedures outlined in the firm’s manual to obtain reasonable assurance that:
  — The nature, timing, and extent of procedures performed are consistent with risk assessments and the approach described in the planning documentation, and that exceptions are appropriately investigated. The appropriateness of planned procedures should be reconsidered if significant changes in risk factors occur or are identified between the planning phase of the engagement and the execution of procedures.
  — Firm-prescribed forms, checklists, and questionnaires, tailored as appropriate, are used in performing and reporting on the engagement.

• Requiring a second review, by a partner or manager, of the report, financial statements, and selected documentation of the work performed and conclusions reached, as prescribed in the firm’s policies and procedures manual. The extent of review varies based on the type of engagement. For example, engagements for financial institutions, high-risk engagements, and those performed for significant clients, as defined by the firm, receive the most extensive review.

• Adhering to the following firm guidelines regarding review of documentation of the work performed and conclusions reached, the financial statements, and documentation of the review process:
  — All reviewers should have appropriate experience, competence, and responsibility and access to the firm’s reference material and other resources.
  — All work performed and the reports and financial statements issued are to be complete and comply with professional standards and firm policy.
— For each engagement, there should be appropriate documentation evidencing review of the documentation of the work performed and conclusions reached, the financial statements, and the report.

• Requiring that all differences of professional judgment within an engagement team be resolved by the engagement and quality control partner. The resolution of the differences should be appropriately documented. If a member of the engagement team continues to disagree with the resolution, he or she may disassociate himself or herself from the resolution of the matter and should be offered the opportunity to document that a disagreement continues to exist.

2.20 Policy 3: Establishing procedures for the review of high-risk engagements. Multi-Office CPA Firm implements this policy by developing procedures with respect to:

• The qualifications of partners performing independent reviews of high-risk engagements. The firm’s procedures require that an independent review partner:
    — Have sufficient technical expertise and experience.
    — Carry out his or her responsibilities with objectivity and due professional care without regard to the relative positions of the audit engagement partner and the independent review partner.
    — 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.

• The nature, timing, and extent of the review. The firm’s procedures require that the independent review partner:
    — Discuss significant accounting, auditing, and financial reporting matters with the engagement partner.
    — Discuss with the engagement partner the engagement team’s identification and audit of high-risk transactions and account balances.
    — Hold a discussion with the engagement team if there has been consultation regarding significant accounting, auditing, or financial reporting matters.
    — Review documentation of the resolution of significant accounting, auditing, and financial reporting matters, including documentation of consultation with firm personnel or external sources.
    — Review the summary of unadjusted audit differences, if one exists.
    — Read the financial statements and auditor’s report.
— Confirm with the engagement partner that there are no significant unresolved matters.
— Review the workpapers to the extent considered necessary or as required by firm policy.
— Complete his or her review before the release of the audit report or reissuance of the audit report if the performance of subsequent-events procedures is required by professional standards.

• The resolution of conflicting opinions between the engagement partner and the independent review partner regarding significant matters. The policy requires documentation of the resolution of conflicting opinions before the release of the audit report or reissuance of the audit report if the performance of subsequent-events procedures is required by professional standards.

• Documentation by the independent review partner. The firm requires:
  — That the engagement files contain evidence that the firm’s policies and procedures with respect to the requirement for independent partner review were complied with before issuance of the firm’s report.
  — Documentation that the independent review partner performed the procedures specified by the firm’s policies.
  — Documentation that no matters have come to the attention of the independent review partner that would cause him or her to believe that (a) the financial statements are not in conformity with U.S. generally accepted accounting principles in all material respects, or (b) the firm’s audit was not performed in accordance with U.S. generally accepted auditing standards.

2.21 Policy 4: The firm identifies areas and specialized situations for which consultation is necessary and requires personnel to refer to authoritative literature and practice aids and to consult, on a timely basis, with individuals within or outside the firm when appropriate, for example, when addressing complex, unusual, or unfamiliar issues. Multi-Office CPA Firm implements this policy by:

• Providing personnel with the firm’s policies and procedures manual which specifies the firm’s consultation policies and procedures. Areas or specialized situations that may require consultation include:
  — 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 date a report was issued.

— Filing requirements of regulators.

— Meetings with regulators at which the firm is to be called upon to support the application of generally accepted accounting principles or generally accepted auditing standards that have been questioned.

— Designating individuals within the firm as consultants in certain areas. Personnel are to consult with the designated individual when issues arise. If differences arise between the engagement partner and the consultant, the matter is to be resolved by the partner(s) responsible for the quality control function.

• Maintaining or providing access to adequate and up-to-date references in each office which includes materials related to specific industries, specialties, and regulatory requirements.

• Requiring that documentation of consultation include all relevant facts and circumstances, the sections of the professional literature used in making a determination, the conclusion reached, and the signatures of the engagement partner and consultant. This documentation is to be retained with the engagement documentation of the work performed and conclusions reached, and, at the discretion of the consultant, entered in a retrievable database to promote consistency in the application of generally accepted accounting principles in similar circumstances.

**Monitoring**

2.22 The objective of the monitoring element of a system of quality control is to provide the firm with reasonable assurance that the policies and procedures relating to the other elements of quality control are suitably designed and effectively applied. Monitoring is an ongoing consideration and evaluation process. Multi-Office CPA Firm satisfies this objective by establishing and maintaining the policies and procedures described in paragraphs 2.23 through 2.26.

2.23 **Policy 1: The firm considers and evaluates, on an ongoing basis, the relevance and adequacy of its quality control policies and procedures.** Multi-Office CPA Firm implements this policy by designating a partner or a management-level individual with appropriate authority to be responsible for quality assurance, including:

• Assuring that the firm’s quality control policies and procedures and its audit methodology remain relevant and adequate. Factors to be considered include:
  
  — Mergers and divestitures of portions of the practice.
  
  — Changes in professional standards and other regulatory requirements applicable to the firm’s practice.
— Results of inspections and peer reviews.
— Reviews of litigation and regulatory enforcement actions against the firm and others.
— The effect that changes in technology may have on a client’s method of doing business.
— Changes in a client’s industry that affect its operations, for example, overcapacity in the telecom industry.
— Changes in applicable AICPA membership requirements.

• Determining whether personnel have been appropriately informed of their responsibilities for maintaining the firm’s standards of quality in performing their duties.

• Identifying the need to:
  — Revise policies and procedures related to the other elements of quality control because they are ineffective or inappropriately designed.
  — Improve compliance with firm policies and procedures related to the other elements of quality control.

2.24 **Policy 2: The firm considers and evaluates, on an ongoing basis, the appropriateness of its guidance materials and practice aids.** Multi-Office CPA Firm implements this policy by:

• Reviewing and updating firm practice aids, such as audit programs, forms, and checklists, to reflect new or revised professional pronouncements.

• Issuing guidance regarding new professional standards, regulatory requirements, and related changes to firm policy.

• Soliciting comments from partners and managers as to the effectiveness of practice aids and tools.

2.25 **Policy 3: The firm considers and evaluates, on an ongoing basis, the effectiveness of its professional development programs.** Multi-Office CPA Firm implements this policy by:

• Designating a partner or qualified individual in each office to review the summary of the evaluations of in-house training programs to determine whether the programs are achieving their objectives.

• Designating a partner or qualified individual in each office to review summaries of CPE records for that office’s professional staff to determine that the office has established a means of tracking each individual’s compliance with the requirements of the AICPA and other applicable regulators.

• Interviewing selected professional personnel regarding the effectiveness of training programs.
• Considering the results of the firm’s inspection as it relates to the effectiveness of the firm’s professional development program.

• Ascertaining whether inquiries received by individuals consulted within the firm indicate the need for additional CPE programs.

2.26 **Policy 4: The firm considers and evaluates, on an ongoing basis, compliance with its policies and procedures and with professional standards.** Multi-Office CPA Firm implements this policy by assigning responsibility to its quality control partner for preparing inspection checklists and guidance materials, or using materials prepared by the AICPA for performing inspection procedures. These procedures include:

• Developing and coordinating the firm’s inspection program to obtain feedback about the effectiveness of the firm’s policies and procedures.

• Developing a plan to test a sample of engagements for compliance with the firm’s policies and procedures. Such a review may be preissuance or postissuance.

• Reviewing the resolution of matters reported by professional personnel on independence-confirmation forms to determine that matters have been appropriately considered and resolved.

• Interviewing personnel at all professional management and staff levels to obtain information about operating procedures in practice offices, whether personnel are knowledgeable about firm policies and procedures, and whether such policies and procedures are being effectively communicated.

• Reviewing the following documentation to determine compliance with firm policies and procedures:
  — Personnel evaluations, including documentation of hiring and advancement decisions
  — Documentation of client acceptance and continuance decisions
  — Participants’ evaluations of practice office training programs
  — Professional development records of personnel
  — Correspondence regarding the resolution of independence matters within the practice office

• Reviewing a cross-section of engagements from selected practice offices using the following criteria for inclusion in the sample selected:
  — Engagements involving all partners and managers who have significant accounting and auditing responsibilities in the selected offices.
  — Engagements for financial institutions.
— First-year engagements.
— Significant client engagements.
— Specialized industries with emphasis given to high-risk industries.
— Level of service performed (audit, review, compilation, and attestation).
— Level of attestation services performed (examination, review, and agreed-upon procedures).
— Engagements for which there have been complaints or allegations that the work performed by the firm fails to comply with professional standards, regulatory requirements, or the firm’s system of quality control.
— Engagements in which there were significant disagreements between the quality review partner and the engagement partner.

• Summarizing findings resulting from the inspection procedures.
• Communicating findings to practice office personnel and determining the corrective actions to be taken for the engagements reviewed. These findings are discussed and communicated in a report issued to each office. The practice office responds regarding the specific corrective actions or steps to be taken to improve compliance with the firm’s policies and procedures and professional standards.
• Preparing a summary inspection report for the firm’s senior management that evaluates the overall results of the inspection to determine whether:
  — The firm as a whole needs to improve compliance with the firm’s policies and procedures.
  — Revisions to the firm’s quality control policies and procedures are necessary.
• Communicating in training programs, partner-manager meetings, and firm policy correspondence the need for improved compliance with the system of quality control.
• Communicating in partner-manager meetings and firm policy correspondence the need for changes in the system of quality control.
• Periodically reviewing the process for personnel evaluation and counseling to ascertain that:
  — Procedures for evaluation and documentation are being followed on a timely basis.
  — Personnel who have been promoted have achieved the applicable requirements for advancement.
  — Personnel decisions are consistent with evaluations.
  — Recognition is given to outstanding performance.
CHAPTER 3: SYSTEM OF QUALITY CONTROL
FOR A CPA FIRM’S ACCOUNTING AND AUDITING
PRACTICE—FIRM WITH A SINGLE OFFICE

3.01 This chapter describes how a CPA firm that has a single office (Single-Office CPA Firm) implements each element of quality control in its accounting and auditing practice. Single-Office CPA Firm is a hypothetical firm with 1 office, 3 partners, and a total of 10 professionals. Its accounting and auditing practice has a concentration of employee benefit plans and the firm has no Securities and Exchange Commission (SEC) clients. The firm uses practice aids that have been subjected to peer review in accordance with standards established by the AICPA. These practice aids are supplemented by oral and written communications from the firm’s partners. To enhance communications, the firm provides its personnel with a written summary of its quality control policies and procedures that contains references to the detailed policies and procedures included in its practice aids.

INDEPENDENCE, INTEGRITY, AND OBJECTIVITY

3.02 The objective of the independence, integrity, and objectivity element of a system of quality control is to provide a firm with reasonable assurance that personnel maintain independence (in fact and in appearance) in all required circumstances, perform all professional responsibilities with integrity, and maintain objectivity in discharging professional responsibilities. Single-Office CPA Firm satisfies this objective by establishing and maintaining the policies and procedures described in paragraphs 3.03 through 3.06.

3.03 Policy 1: Personnel adhere to applicable independence, integrity, and objectivity requirements such as those in regulations, interpretations, and rules of the AICPA, state CPA societies, state boards of accountancy, state statutes, the U.S. Government Accountability Office2 (GAO), Department of Labor (DOL), Federal Deposit Insurance Corporation (FDIC), and any other applicable regulators. Single-Office CPA Firm implements this policy by:

- Designating a quality assurance partner to review relevant pronouncements relating to independence, integrity, and objectivity, answer questions, and resolve matters.
- Subscribing to the AICPA Professional Standards service.

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1 If Single-Office CPA Firm were to be engaged to perform audit services for an issuer, it might need to revise its quality control policies and procedures to comply with Public Company Accounting Oversight Board (PCAOB) standards and to reflect Securities and Exchange Commission (SEC) requirements applicable to audits of issuers.
2 The U.S. Government Accountability Office was formerly known as the U.S. General Accounting Office.
• Identifying circumstances for which documentation of the resolution of matters is appropriate.

• Assigning responsibility to specified individuals for obtaining written representations from personnel, upon hire and on an annual basis, concerning whether they are familiar with and in compliance with professional standards and the firm’s policies and procedures regarding independence, integrity, and objectivity.

• Assigning responsibility to specified individuals for reviewing these independence representations for completeness, and for resolving reported exceptions.

• Requiring all professional personnel assigned to an engagement to sign a step in the engagement program attesting to his or her independence.

• Having a partner, or an individual designated by the partner, periodically review unpaid fees from clients to ascertain whether any outstanding amounts impair the firm’s independence.

• Establishing a system for identifying all services performed for each client.

3.04 Policy 2: The firm’s senior management sets a tone for the organization that stresses the importance of ethical values, especially as they pertain to accounting and auditing engagements, and communicates related policies and procedures to firm personnel. Single-Office CPA Firm implements this policy by:

• Having the managing partner (through e-mails, letters, recordings, and so on), emphasize the concepts of independence, integrity, and objectivity (including the significance of client\(^3\) engagements) in its professional development meetings, in the acceptance and continuance of clients and engagements, and in the performance of engagements.

• Providing each of its professional personnel with access to applicable professional and regulatory literature and advising them that they are expected to be familiar with that literature.

• Requiring periodic independence and ethics training for all professional personnel. Such training covers the firm’s independence and ethics policies and the independence and ethical requirements of all applicable regulators.

• Informing personnel on a timely basis of those entities to which independence policies apply, by:

\(^3\) In broad terms, the significance of a client to a member or a firm refers to relationships that could diminish a practitioner’s objectivity and independence in performing attest services. Examples of factors to consider in determining the significance of a client to an engagement partner, office, or practice unit include (a) the amount of time the partner, office, or practice unit devotes to the engagement, (b) the effect on the partner’s stature within the firm as a result of his or her service to the client, (c) the manner in which the partner, office, or practice unit is compensated, or (d) the effect that losing the client would have on the partner, office, or practice unit.
— Preparing and maintaining a list of entities with which firm personnel are prohibited from having a business relationship.

— Making the list available to personnel so they may evaluate their independence (including personnel new to the firm).

— Notifying personnel on a timely basis of changes in the list.

3.05 **Policy 3: The firm establishes procedures to help mitigate possible threats to independence and objectivity.** Single-Office CPA Firm implements this policy by:

- Assigning a second partner, who is not otherwise associated with the engagement, to perform a concurring review of all audit and attest engagements.

- Designing and implementing compensation systems that (a) reward partners and staff involved in the accounting and auditing practice for the quality of their work and their compliance with professional standards, and (b) provide disincentives for behavior that might be perceived as impairing the independence or objectivity of their work, for example, the cross-selling of certain consulting services.

- Establishing additional procedures that provide safeguards when the firm performs audit or other attest work for (a) significant clients or (b) clients at which partners or other senior personnel are offered management positions, or accept offers of employment.

3.06 **Policy 4: The firm establishes procedures for confirming the independence of other firms who are performing part of an engagement.** Single-Office CPA Firm implements this policy by:

- Using practice aids that prescribe the form, content, and frequency of independence representations to be obtained.

- Requiring that such representations be documented.

**Personnel Management**

3.07 The objective of the personnel management element of a system of quality control is to provide the firm with reasonable assurance that all personnel have the competency to perform their assigned responsibilities. Attributes or qualities that enhance the competency of personnel who perform, supervise, or review work include integrity, objectivity, intelligence, judgment, experience, and motivation. Single-Office CPA Firm satisfies this objective by establishing and maintaining the policies and procedures in paragraphs 3.08 through 3.12.
3.08 **Policy 1: Personnel who are hired possess the characteristics that enable them to perform competently.** Single-Office CPA Firm implements this policy by:

- Designating a qualified individual in the firm to be responsible for:
  - Managing the human resources function.
  - Evaluating the firm’s personnel needs by considering factors such as existing clientele, anticipated growth, personnel turnover, and individual advancement.
  - Developing criteria for determining which individuals will be involved in the interviewing and hiring process.
- Establishing an understanding among the partners about the attributes, achievements, and experiences desired in entry-level and experienced personnel.
- Establishing criteria for evaluating personal characteristics such as integrity, competence, and motivation.
- Setting guidelines for the additional procedures to be performed when hiring experienced personnel, such as performing background checks and inquiring about any outstanding regulatory actions.

3.09 **Policy 2: The firm assigns personnel (including partners) based on the knowledge, skills, and abilities required in the circumstances, and the nature and extent of supervision needed.** Single-Office CPA Firm implements this policy by:

- Designating an appropriate person in each office to be responsible for assigning personnel to engagements based on such factors as:
  - Engagement type, size, significance, complexity, and risk profile.
  - Specialized experience and expertise required for the engagement and competencies gained through prior experience.
  - Personnel availability.
  - Timing of the work to be performed.
  - Continuity and rotation of personnel.
  - Opportunities for on-the-job training.
  - Situations for which independence or objectivity concerns exist.
- Specifying the competencies that the practitioners-in-charge of the firm’s accounting, auditing, and attestation engagements (or other persons responsible for supervising and signing or authorizing someone to sign the firm’s report on such engagements) should possess to ac-
complish their engagement responsibilities. These competencies include having an understanding of:

— The role of the firm’s system of quality control and the AICPA’s Code of Professional Conduct in assuring the integrity of the accounting, auditing, and attest functions to users of reports.

— The performance, supervision, and reporting aspects of the engagement, which ordinarily are gained through participation or training in similar engagements.

— The professional standards applicable to the engagement and the industry in which the client operates. Such standards include accounting, auditing, and attestation standards, as well as rules and regulations issued by other applicable regulators.

— The industry in which the client operates, including its organization and operating characteristics, sufficient to identify areas of high or unusual risk associated with the engagement, and to evaluate the reasonableness of industry-specific estimates.

— The skills that contribute to sound professional judgment, including the ability to exercise professional skepticism.

— How the organization uses information technology, and the manner in which information systems are used to record and maintain financial information.

The individual who makes partner and manager assignments should be a partner, and in the case of high-risk engagements or those performed for significant clients, second-level approval of such assignments should be obtained from the managing or other partner.

3.10 Policy 3: Personnel participate in general and industry-specific continuing professional education (CPE) and professional development activities that should enable them to accomplish assigned responsibilities and satisfy applicable CPE requirements of the AICPA, state CPA societies, state boards of accountancy, and other applicable regulators. Single-Office CPA Firm implements this policy by:

- Assigning responsibility to a partner to maintain an office professional development program that:
  
  — Requires personnel to participate in professional development programs in accordance with firm guidelines and in subjects that are relevant to their responsibilities.
  
  — Takes into account the requirements of the AICPA and state boards of accountancy in establishing the firm’s CPE requirements.
  
  — Provides course materials for and maintains records of CPE completed by professional personnel.
  
  — Provides an orientation and training program for new hires.
• Encouraging participation by personnel at each level in the firm in other professional development activities such as external professional development programs, including graduate-level and self-study courses, membership in professional organizations, serving on professional committees, writing for professional publications, and speaking to professional groups.

• Communicating and distributing to personnel, when applicable, changes in accounting, auditing, and independence requirements, and the firm’s guidance with respect to these requirements.

3.11 **Policy 4: Only those individuals who have the qualifications necessary to accomplish the responsibilities they will be called on to assume are selected for advancement.** Single-Office CPA Firm implements this policy by:

• Assigning responsibility to a partner for making advancement and termination decisions. Such responsibilities include:
  
  — Identifying criteria for evaluating personnel at each professional level and for advancement to the next higher level of responsibility. Such criteria give due recognition and reward to the development and maintenance of competence and commitment to ethical principles.

  — Informing firm personnel about the criteria for advancement to the next higher level of responsibility.

  — Designating personnel responsible for preparing evaluations and determining when they should be prepared.

  — Informing personnel that failure to adhere to the firm’s policies and procedures regarding performance quality and commitment to ethical principles may result in disciplinary action.

  — Using forms that include the applicable qualifications when evaluating the performance of personnel. Such forms include qualifications related to performance quality and adherence to ethical principles.

  — Reviewing evaluations on a timely basis with the individual being evaluated.

• Counseling personnel regarding their progress and career opportunities by:

  — Annually summarizing and reviewing with personnel the evaluation of their performance, including an assessment of their progress with the firm. Considerations should include past performance, future objectives of the individual and the firm, the individual’s assignment preferences, and career opportunities.

  — Periodically evaluating partners by means of counseling, peer evaluation, or self-appraisal, as appropriate.
3.12 **Policy 5:** Partners and senior-level employees are compensated in a manner that provides an incentive and reward for quality work and for maintaining independence, integrity, and objectivity. Single-Office CPA Firm implements this policy by:

- Establishing a compensation system that predominantly rewards accounting and auditing partners and senior-level employees for the quality of their accounting and auditing work. The compensation system:
  - Takes into consideration firm feedback based on concurring reviews, internal inspections, and outside reviews of the work performed.
  - Rewards partners and personnel for timely (a) identifying significant and emerging accounting and auditing issues and (b) seeking consultation with firm experts.
  - Does not include any material rewards for the cross-selling of services.

### Acceptance and Continuance of Clients and Engagements

3.13 The objective of the acceptance and continuance of clients and engagements element of a system of quality control is to establish criteria 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.
- The firm undertakes only those engagements that can be completed with professional competence.
- The risks associated with providing professional services in particular circumstances are appropriately considered.
- An understanding with the client regarding the services to be performed is reached.

Single-Office CPA Firm satisfies this objective, with respect to the initial period for which the firm is performing its service and for subsequent periods, by establishing and maintaining the policies and procedures described in paragraphs 3.14 through 3.16.

3.14 **Policy 1:** The firm evaluates factors that have a bearing on management’s integrity. Single-Office CPA Firm implements this policy by:

- Informing personnel of the firm’s policies and procedures for accepting and continuing clients, including those outlined in the firm’s practice aids.
- Obtaining and evaluating available financial information regarding the client and its operations such as annual reports, interim financial statements, reports to and from regulators, income tax returns, and credit reports before accepting or continuing a client.
• Making inquiries of client management about the nature and purpose of the services to be provided.

• Making inquiries of the client’s bankers, factors, attorneys, credit services, and others who have business relationships with the entity.

• Communicating with the predecessor accountant or auditor when required or suggested by professional standards. If the contemplated engagement is an audit, the partner should ensure that Statement on Auditing Standards (SAS) No. 84, *Communications Between Predecessor and Successor Auditors* (AICPA, *Professional Standards*, vol. 1, AU sec. 315), as amended, is followed, specifically AU section 315.09.

If after taking the steps described above, the firm is unable to obtain sufficient information about the prospective client, or there is an indication that management or someone affiliated with the prospective client may be less than reputable, the firm conducts a background check of the business, its officers, and the person(s) in question. The firm accomplishes this by using the services of a company specializing in background checks and evaluating the information obtained regarding management’s integrity.

3.15 **Policy 2:** The firm *(a)* evaluates whether the engagement can be completed with professional competence, *(b)* undertakes only those engagements that can be completed with professional competence, and *(c)* considers the risk associated with providing professional services in particular circumstances. Single-Office CPA Firm implements this policy by:

• Evaluating whether the firm has obtained or can reasonably expect to obtain the knowledge and expertise necessary to perform the engagement.

• Specifying conditions that trigger the requirement to reevaluate a specific client or engagement. The following are examples of such conditions:

  — Significant changes in the client, for example, a major change in senior client personnel, ownership, advisers, the nature of its business, or the financial stability of the client.

  — Changes in the nature or scope of the engagement, including requests for additional services.

  — Changes in the composition of the firm, for example, the loss of and inability to replace key personnel who are particularly knowledgeable about a specialized industry.

  — The decision to discontinue services to clients in a particular industry.

  — The existence of conditions that would have caused the firm to reject the client or engagement had such conditions existed at the time of the initial acceptance.

  — The client has been delinquent in paying fees. (This may also affect the firm’s independence.)
— Engagements for entities operating in highly specialized or regulated industries, including financial institutions, governmental entities, and employee benefit plans.

— Engagements that require a burdensome amount of time to complete relative to the available resources of the firm.

— Engagements for entities in the development stage.

— Engagements in which the client has ignored prior recommendations, for example, recommendations that address deficiencies in internal control.

• Obtaining relevant information to determine whether the relationship should be continued, and establishing a frequency for evaluations (for example, continuance decisions should be made at least annually).

• Evaluating the information obtained regarding acceptance or continuance of the client or engagement by having:
  
  — The engagement partner evaluate the information obtained about the client or the specific engagement, including information about the significance of the client to the firm,\(^4\) and make a recommendation about whether the client or engagement should be accepted or continued.

  — The engagement partner complete a client acceptance form and submit it to the managing partner for approval.

  — The engagement partner sign a step in the planning program noting client continuance, and complete a form documenting client continuance if conditions exist that trigger the requirement between annual audits to reevaluate a client or engagement.

  — The managing partner evaluate and approve the recommendation made by the engagement partner. If the managing partner recommends not accepting a client or discontinuing a client relationship, the managing partner discusses his or her reasons for the acceptance or continuance decision with the other partners.

3.16 **Policy 3: The firm obtains an understanding with the client regarding the services to be performed.** Single-Office CPA Firm implements this policy by obtaining, for all engagements, a written and signed engagement letter thus minimizing the risk of misunderstanding regarding the nature, scope, and limitations of the services to be performed.

\(^4\) See footnote 3.
3.17 The objective of the engagement performance element of a system of quality control is to provide the firm with reasonable assurance that the work performed by engagement personnel meets the applicable professional standards, regulatory requirements, and the firm’s standards of quality. 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. Policies and procedures also should require that personnel refer to authoritative literature or other sources and consult, on a timely basis, with individuals within or outside the firm, when appropriate. Single-Office CPA Firm satisfies this objective by establishing and maintaining the policies and procedures described in paragraphs 3.18 through 3.21.

3.18 Policy 1: Planning for engagements meets professional, regulatory, and the firm’s requirements. Single-Office CPA Firm implements this policy by maintaining and providing personnel with the firm’s practice aids which prescribe the factors the engagement team should consider in the planning process and the extent of documentation of those considerations. Planning considerations may vary depending on the size and complexity of the engagement, but generally include:

- Assigning responsibilities to appropriate personnel during the planning phase.
- Developing or updating background information on the client and the engagement.
- Developing a planning document that includes:
  - Proposed work programs tailored to the specific engagement.
  - Staffing requirements and the need for specialized knowledge.
  - The economic conditions affecting the client and its industry and their potential effect on the conduct of the engagement.
  - The audit risks, including fraud considerations, affecting the client and the engagement and how they may affect the procedures performed.
  - A budget that allocates a sufficient amount of time for the engagement to be performed in accordance with professional standards and the firm’s quality control policies and procedures.

3.19 Policy 2: The engagement is performed, supervised, reviewed, documented, and reported (or communicated) in accordance with the requirements of professional standards, applicable regulators, and the firm. Single-Office CPA Firm implements this policy by:
• Providing adequate supervision during the course of an engagement. The training, ability, and experience of the personnel are considered when assigning supervisors to the engagement.

• Requiring that a written work program be used in all engagements.

• Adhering to the guidelines set forth by the firm for the form and content of documentation of the work performed and conclusions reached. Such documentation includes standardized forms, checklists, and questionnaires used in the performance of engagements and explanations, when required, of how the firm integrates such aids into engagements.

• Requiring documentation in the working papers in accordance with professional standards and the firm’s policies.

• Adhering to the following guidelines established by the firm regarding review of the documentation of the work performed and conclusions reached, the financial statements, and reports:
  — All reviewers are to have appropriate experience, competence, and responsibility.
  — All work performed and the reports and financial statements issued are to be complete and comply with professional standards and firm policy.
  — For each engagement, there should be evidence of appropriate review of documentation of the work performed and conclusions reached, the financial statements, and the report.
  — All differences of professional judgment among members of an engagement team are to be resolved by the engagement partner and the managing partner. The resolution of differences should be appropriately documented. If a member of the team continues to disagree with the resolution, he or she may disassociate himself or herself from the resolution of the matter and should be offered the opportunity to document that a disagreement continues to exist.

3.20 **Policy 3: Establishing procedures for the review of high-risk engagements.** Single-Office CPA Firm implements this policy by developing procedures with respect to:

• The qualifications of partners performing independent reviews of high-risk engagements. The firm’s procedures require that an independent review partner:
  — Have sufficient technical expertise and experience.
  — Carry out his or her responsibilities with objectivity and due professional care without regard to the relative positions of the audit engagement partner and the independent review partner.
  — 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.
• The nature, timing, and extent of the review. The firm’s procedures require that the independent review partner:
  — Discuss significant accounting, auditing, and financial reporting matters with the engagement partner.
  — Discuss with the engagement partner the engagement team’s identification and audit of high-risk transactions and account balances.
  — Hold a discussion with the engagement team if there has been consultation regarding significant accounting, auditing, or financial reporting matters.
  — Review documentation of the resolution of significant accounting, auditing, and financial reporting matters, including documentation of consultation with firm personnel or external sources.
  — Review the summary of unadjusted audit differences, if one exists.
  — Read the financial statements and auditor’s report.
  — Confirm with the engagement partner that there are no significant unresolved matters.
  — Review the workpapers to the extent considered necessary or as required by firm policy.
  — Complete his or her review before the release of the audit report or reissuance of the audit report if the performance of subsequent-events procedures is required by professional standards.

• The resolution of conflicting opinions between the engagement partner and the independent review partner regarding significant matters. The policy requires documentation of the resolution of conflicting opinions before the release of the audit report or reissuance of the audit report if the performance of subsequent-events procedures is required by professional standards.

• Documentation by the independent review partner. The firm requires:
  — That the engagement files contain evidence that the firm’s policies and procedures with respect to the requirement for independent partner review were complied with before issuance of the firm’s report.
  — Documentation that the independent review partner performed the procedures specified by the firm’s policies.
  — Documentation that no matters have come to the attention of the independent review partner that would cause him or her to believe that (a) the financial statements are not in conformity with U.S. generally accepted accounting principles in all material respects, or (b) the firm’s audit was not performed in accordance with U.S. generally accepted auditing standards.
3.21 **Policy 4:** The firm identifies areas and specialized situations for which consultation is necessary and requires personnel to refer to authoritative literature and practice aids, and consult, on a timely basis, with individuals within or outside the firm when appropriate, for example, when addressing complex, unusual, or unfamiliar issues. Single-Office CPA Firm implements this policy by:

- Informing personnel of the firm’s consultation policies and procedures.
- Requiring consultation in specialized areas or situations with appropriate individuals within and outside the firm when matters such as the following arise:
  - The application of newly issued technical pronouncements.
  - Industries with special accounting, auditing, or reporting requirements, including unusually complex employee benefit plans.
  - 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 date a report was issued.
  - Filing requirements of regulators.
  - 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.
- Providing all professional personnel with access to adequate and current reference materials.
- Including all relevant facts, circumstances, the professional literature used, and conclusions reached in the engagement documentation of the work performed and conclusions reached.
- Documenting the resolution of differences of opinion. If there is an unresolved disagreement, an outside source may be consulted to assist in determining the appropriate application of accounting principles.

**Monitoring**

3.22 The objective of the monitoring element of a system of quality control is to provide the firm with reasonable assurance that the policies and procedures relating to the other elements of quality control are suitably designed and effectively applied. Monitoring is an ongoing consideration and evaluation process. Single-Office CPA Firm satisfies this objective by establishing and maintaining the policies and procedures described in paragraphs 3.23 through 3.26.
3.23 **Policy 1: The firm considers and evaluates, on an ongoing basis, the relevance and adequacy of its quality control policies and procedures.** Single-Office CPA Firm implements this policy by designating a partner or a management-level individual to be responsible for quality assurance, including:

- Assuring that the firm’s quality control policies and procedures and its audit methodology remain relevant and adequate. Factors to be considered include:
  - Mergers and divestitures of portions of the practice.
  - Changes in professional standards or other regulatory requirements applicable to the firm’s practice.
  - Results of inspections and peer reviews.
  - Review of litigation and regulatory enforcement actions against the firm and its personnel.
  - The effect that changes in technology may have on a client’s method of doing business.
  - Changes in a client’s industry that may affect its operations.
  - Changes in applicable AICPA membership requirements.
- Determining whether personnel have been appropriately informed of their responsibilities for maintaining the firm’s standards of quality in performing their duties.
- Identifying the need to:
  - Revise policies and procedures related to the other elements of quality control because they are ineffective or inappropriately designed.
  - Improve compliance with firm policies and procedures related to the other elements of quality control.

3.24 **Policy 2: The firm considers and evaluates, on an ongoing basis, the appropriateness of its guidance materials and practice aids.** Single-Office CPA Firm implements this policy by:

- Reviewing and evaluating firm practice aids, such as audit programs, forms, and checklists, and considering whether they reflect recent professional pronouncements.
- Providing information during staff meetings regarding new professional standards, regulatory requirements, and the related changes that should be made to firm practice aids.

3.25 **Policy 3: The firm considers and evaluates, on an ongoing basis, the effectiveness of its professional development activities.** Single-Office CPA Firm implements this policy by:
• Designating a management-level individual to be responsible for reviewing the professional development policies and procedures to determine whether they are appropriate, effective, and meet the needs of the firm.

• Designating a management-level individual to review summaries of the CPE records of the firm’s professional personnel to evaluate each individual’s compliance with the requirements of the AICPA and other applicable regulators.

• Soliciting information from the firm’s personnel during staff meetings regarding the effectiveness of training programs.

3.26 **Policy 4: The firm considers and evaluates, on an ongoing basis, its compliance with firm policies and procedures and with professional standards.** For purposes of illustrating policy 4, two scenarios are described: scenario 1 illustrates how Single-Office CPA Firm would satisfy the objective of policy 4 by reviewing engagements throughout the year; scenario 2 illustrates how Single-Office CPA Firm would implement policy 4 by reviewing engagements during a designated period in the year.

3.27 In determining which scenario is appropriate, consideration should be given to Statement on Quality Control Standards (SQCS) No. 3, *Monitoring a CPA Firm’s Accounting and Auditing Practice* (AICPA, Professional Standards, vol. 2, QC sec. 30.03-.07), which establishes guidance for determining the extent of the inspection procedures to be performed, including those related to individual engagements.

3.28 **Scenario 1: Reviewing Engagements Throughout the Year.** Single-Office CPA Firm implements policy 4 by:

• Designating a partner or management-level individual not previously associated with the engagement to perform either a preissuance or postissuance review of the engagement.

• Establishing the approach for performing preissuance or postissuance reviews, for example, the comprehensiveness of the review and the frequency for summarizing findings (for example, monthly, quarterly). The comprehensiveness of the review of selected engagements should be similar to that performed in an inspection or peer review.

• Designating the forms and checklists to be used during the engagement and functional element reviews and the extent of the documentation required. (Examples of functional elements are the human resources function and the firm’s library.)

• Selecting a cross-section of engagements at the beginning of the monitoring year for preissuance or postissuance review and reevaluating that selection throughout the year as circumstances dictate. Criteria used for selecting engagements include:
  — Significant specialized industries with emphasis on high-risk engagements.
— Audits of the financial statements of employee benefit plans.
— First-year engagements.
— Significant client engagements.
— Level of service performed (that is, audit, review, compilation, and attest).
— Engagements performed by all partners and other management level personnel having accounting and auditing responsibilities.
— Engagements performed under government auditing standards (Yellow Book engagements).
— Engagements for which there have been complaints or allegations from firm personnel, clients, or other third parties that the work performed by the firm failed to comply with professional standards, regulatory requirements, or the firm’s system of quality control.
— Engagements in which there were significant disagreements between the quality review partner and the engagement partner.

- Reviewing the selected engagements. Deficiencies identified as a result of this process are summarized and evaluated to determine whether:
  — Additional emphasis should be placed on specific areas or industries in future engagements.
  — Existing policies and procedures should be modified to prevent the deficiencies noted from recurring.

- At least annually, reviewing other engagement files for compliance with the firm’s quality control policies and procedures including reviewing correspondence regarding consultation on independence, integrity, and objectivity matters, for example, assessments of significant clients, and acceptance and continuance decisions.

- Reviewing the resolution of matters reported by professional personnel regarding independence to determine that matters have been appropriately considered and resolved.

- Summarizing the deficiencies noted resulting from the preissuance and postissuance reviews.

- Preparing a summary of the deficiencies noted so that the partner or management group may incorporate any recommended changes in the firm’s policies and procedures.

- Communicating to all professional personnel the deficiencies noted and related changes in quality control procedures.

- Following up on planned corrective actions to determine whether the actions were taken as planned and whether they achieved the intended objectives.
3.29 **Scenario 2: Reviewing a Sample of Engagements During a Designated Period of the Year.** Single-Office CPA Firm implements policy 4 by:

- Designating a partner to be responsible for performing an annual inspection using guidance prepared by the AICPA for performing inspection procedures. These procedures include reviewing a cross-section of engagements using the following criteria in selecting engagements:
  - Significant specialized industries with emphasis on high-risk engagements.
  - Audits of the financial statements of employee benefit plans.
  - First-year engagements.
  - Significant client engagements.
  - Level of service performed (that is, audit, review, compilation, and attest).
  - Engagements performed by all partners and other management level personnel having accounting and auditing responsibilities.
  - Engagements performed under government auditing standards (Yellow Book engagements).
  - Engagements for which there have been complaints or allegations from firm personnel, clients, or other third parties that the work performed by the firm failed to comply with professional standards, regulatory requirements, or the firm’s system of quality control.
  - Engagements in which there were significant disagreements between the quality review partner and the engagement partner.

- Establishing an approach and timetable for performing the inspection procedures and determining the forms and checklists to be used during the inspection and the extent of documentation required.

- Deciding how long to retain detailed inspection documentation (as opposed to summaries).

- Selecting a sample of engagements for review and reevaluating that selection throughout the process.

- Selecting other engagement files to determine compliance with the firm’s quality control policies and procedures and reviewing the selected engagements.

- Reviewing correspondence regarding consultation on independence, integrity, and objectivity matters, and acceptance and continuance decisions.

- Reviewing the resolution of matters reported by professional personnel regarding independence to determine that matters have been appropriately considered and resolved.

- Summarizing findings resulting from the inspection procedures.
• Preparing a summary inspection report for the partner or management group that evaluates the overall results of the inspection and sets forth any recommended changes that should be made to the firm’s policies and procedures.

• Reviewing the recommended corrective actions and reaching final conclusions as to the actions to be taken.

• Communicating inspection findings and quality control changes to all professional personnel.

• Following up on planned corrective actions to determine whether those actions were taken and whether they achieved the intended objective(s).
4.01 This chapter describes how a sole practitioner (Sole Practitioner, CPA) implements each element of quality control in his or her accounting practice. Sole Practitioner, CPA is a hypothetical firm of which Sole Practitioner is the sole owner. The firm has no professional staff; however, on occasion Sole Practitioner, CPA, hires per diem professionals. Her accounting practice consists only of engagements subject to Statements on Standards for Accounting and Review Services (SSARSs). She uses practice aids that have been subjected to peer review in accordance with standards established by the AICPA. Sole Practitioner, CPA, uses per diem personnel to assist her and recognizes that her policies and procedures would have to change if she were to perform audit or attest engagements, or hire full-time or part-time professional staff.

**INDEPENDENCE, INTEGRITY, AND OBJECTIVITY**

4.02 The objective of the independence, integrity, and objectivity element of a system of quality control is to provide a firm with reasonable assurance that personnel maintain independence (in fact and in appearance) in all required circumstances, perform all professional responsibilities with integrity, and maintain objectivity in discharging their professional responsibilities. Sole Practitioner, CPA, satisfies this objective by establishing and maintaining the policy and procedures described in paragraphs 4.03 and 4.04.

4.03 **Policy 1: I adhere to applicable independence, integrity, and objectivity requirements such as those in regulations, interpretations, and rules of the AICPA, state CPA societies, state boards of accountancy, state statutes, and other applicable regulators.** Sole Practitioner, CPA, implements this policy by:

- Subscribing to AICPA *Professional Standards*.
- Consulting the AICPA Web site for information about changes in professional ethics and independence standards.
- Reviewing unpaid client fees to ascertain whether any outstanding amounts impair the firm’s independence.
- Reviewing relevant pronouncements published in the *Journal of Accountancy* relating to independence, integrity, and objectivity, and retaining relevant issues of the *Journal of Accountancy*. 
• Ensuring that per diem personnel are aware of financial, family, business, and other relationships that may be prohibited by applicable requirements.

• Signing a step on each engagement program attesting to her independence, and requiring per diem personnel to do the same.

• Attending periodic professional training in ethics and independence.

• Complying with SSARSs by disclosing in the accountant’s compilation report instances in which the firm is not independent.

• Considering the significance of the client to the firm.\(^1\)

**4.04 Policy 2: I establish procedures to help mitigate possible threats to my independence and objectivity.** Sole Practitioner, CPA implements this policy by:

• Subjecting review engagements for significant clients (or other high-risk engagements) to preissuance review by another firm.

**PERSONNEL MANAGEMENT**

**4.05** The objective of the personnel management element of a system of quality control is to provide a firm with reasonable assurance that all personnel have the competency to perform their assigned responsibilities. Attributes or qualities that enhance the competency of personnel who perform, supervise, or review work include integrity, objectivity, intelligence, judgment, experience, and motivation. Sole Practitioner, CPA, satisfies this objective by establishing and maintaining the policy and procedures described in paragraph 4.06.

**4.06 Policy 1: I maintain the knowledge, skills, and abilities required in the circumstances by participating in general and industry-specific continuing professional education (CPE) and professional development activities that should enable me to accomplish my responsibilities and satisfy applicable CPE requirements of the AICPA, state CPA societies, state boards of accountancy, and other applicable regulators. I also monitor the compliance of per diem employees with CPE requirements.** Sole Practitioner, CPA, implements this policy by:

• Maintaining the competencies necessary to accomplish responsibilities related to each of the firm’s engagements.

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\(^1\) In broad terms, the significance of a client to a member or a firm refers to relationships that could diminish a practitioner’s objectivity and independence in performing attest services. Examples of factors to consider in determining the significance of a client to an engagement partner, office, or practice unit include \((a)\) the amount of time the partner, office, or practice unit devotes to the engagement, \((b)\) the effect on the partner’s stature within the firm as a result of his or her service to the client, \((c)\) the manner in which the partner, office, or practice unit is compensated, or \((d)\) the effect that losing the client would have on the partner, office, or practice unit.
• Establishing a professional development program that takes into account the requirements of the AICPA and state boards of accountancy.

• Participating in external professional development programs, including graduate-level and self-study courses.

• Joining and becoming an active member of professional organizations.

• Serving on professional committees, writing for professional publications on topics she is knowledgeable about, and participating in other professional activities.

• Considering changes in the applicable professional standards when determining her professional development program.

• Setting criteria that per diem personnel must meet to competently perform engagements, for example:
  — Determining that per diem personnel are in compliance with the applicable professional education requirements of the AICPA, state boards of accountancy, and state CPA societies.
  — Obtaining and retaining documentation of such compliance.

• Evaluating the knowledge and expertise required to perform an engagement prior to accepting the client or engagement.

• Receiving professional publications, such as state society journals, to keep abreast of changes in accounting standards and any client industry-specific pronouncements.

• Consulting the AICPA Web site for information about changes in professional standards.

**Acceptance and Continuance of Clients and Engagements**

4.07 The objective of the acceptance and continuance of clients and engagements element of a system of quality control is to establish criteria for deciding whether to accept or continue a client relationship and whether to perform a specific engagement for a 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.

• The firm undertakes only those engagements that can be completed with professional competence.

• The risks associated with providing professional services in particular circumstances are appropriately considered.

• An understanding with the client regarding the services to be performed is reached.
Sole Practitioner, CPA, satisfies this objective, with respect to the initial period for which the firm is performing its service and for subsequent periods, by establishing and maintaining the policies and procedures described in paragraphs 4.08 through 4.10.

4.08  **Policy 1: I evaluate factors that have a bearing on management’s integrity.** Sole Practitioner, CPA, implements this policy by:

- Obtaining information such as the following before accepting or continuing a client:
  - The nature and purpose of the services to be provided.
  - Information regarding the client and its operations from sources such as prior-year reports, internally generated financial statements (if applicable), income tax returns, and credit reports.
- Inquiring of third parties such as bankers, factors, and legal counsel about management’s integrity.
- Communicating with the predecessor accountant when required or suggested by professional standards.2
- Evaluating the information obtained regarding management’s integrity.

4.09  **Policy 2: I accept or continue to perform only those engagements I can complete with professional competence, and appropriately consider the risk associated with providing professional services in particular circumstances.** Sole Practitioner, CPA, implements this policy by:

- Establishing a cut-off date by which evaluations of engagements should be performed, for example, before work on the current-year engagement begins.
- Considering conditions, such as the following, that require reevaluation of a client or specific engagement, and obtaining the relevant information to determine whether the relationship should be continued:
  - Significant changes in the client, for example, a major change in ownership, senior client personnel, directors, advisers, the nature of the business, or the financial stability of the client.
  - Changes in the nature or scope of the engagement, including requests for additional services.

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2 Statement on Standards for Accounting and Review Services No. 4, *Communications Between Predecessor and Successor Accountants* (AICPA, *Professional Standards*, vol. 2, AR sec. 400) provides guidance on communications between a predecessor and successor accountant when the successor accountant decides to communicate with the predecessor accountant. It also requires a successor accountant who becomes aware of information that leads him or her to believe the financial statements reported on by the predecessor accountant may require revision to request that the client communicate this information to the predecessor accountant.
— Client significance.
— Matters that would have caused the firm to reject the client or engagement had such conditions existed at the time of the initial acceptance.
— The client has been delinquent in paying fees. (This also may affect the firm’s independence.)

- Determining if she has the knowledge and expertise to perform the engagement or whether it reasonably can be obtained.
- Evaluating the information obtained regarding the engagement, making the acceptance or continuance decision, and documenting her evaluation or conclusion in a memorandum or by signing off next to the relevant item in a practice aid.

4.10 Policy 3: **I establish an understanding with the client regarding the services to be performed.** Sole Practitioner, CPA, implements this policy by:

- Adhering to all requirements set forth in professional standards regarding obtaining an understanding with the client.
- Requiring that the understanding with the client be documented either through an engagement letter or in a memorandum.

**Engagement Performance**

4.11 The objective of the engagement performance element of a system of quality control is to provide the firm with reasonable assurance that the work performed by engagement personnel meets the applicable professional standards, regulatory requirements, and the firm’s standards of quality. 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. Policies and procedures also should require 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. Sole Practitioner, CPA, satisfies this objective by establishing and maintaining the policies and procedures described in paragraphs 4.12 through 4.14.

4.12 **Policy 1: I plan engagements to meet professional standards and the firm’s requirements.** Sole Practitioner, CPA, implements this policy by adhering to professional standards regarding the planning process and the extent of documentation of the planning, if applicable. Engagement planning considerations may include:
• Developing or updating client information.
• Assessing the significance of the client to her firm.

Obtaining an engagement letter for engagements performed under SSARSs. (SSARS No. 1, Compilation and Review of Financial Statements [AICPA, Professional Standards, AR sec. 100.20], requires the accountant to either issue a compilation report or document an understanding with the entity through the use of an engagement letter when the accountant submits financial statements to a client that are not expected to be used by a third party.)

• Reviewing prior financial statements and accountants’ reports.
• Using work programs and applicable reporting and disclosure checklists.

4.13 Policy 2: I perform, supervise, review, document, and report (or communicate) in accordance with the requirements of professional standards and the firm. Sole Practitioner, CPA, implements this policy by:

• Requiring the use of appropriate practice aids in all engagements.
• Maintaining the availability of current practice aids and AICPA professional standards.
• Documenting the work performed in accordance with professional standards and the firm’s policy.
• Reviewing and initialing all engagement documentation prepared by per diem personnel.

4.14 Policy 3: I identify areas and specialized situations for which consultation is necessary. I require personnel to refer to authoritative literature and practice aids and consult, on a timely basis, with individuals outside the firm when appropriate, for example, when addressing complex, unusual, or unfamiliar issues. Sole Practitioner, CPA, implements this policy by:

• Maintaining access to current technical references to assist in resolving practice problems.
• Referring to the AICPA’s Technical Hotline or other qualified individuals if a practice problem arises for which the firm needs additional expertise.
• Requiring that documentation of consultation include all relevant facts and circumstances and references to professional literature used in the analysis of the matter and the conclusion reached. This documentation is retained with the engagement documentation.

**MONITORING**

4.15 The objective of the monitoring element of a system of quality control is to provide the firm with reasonable assurance that the procedures relating to the other elements of quality con-
trol are suitably designed and effectively applied. Monitoring is an ongoing consideration and evaluation process. Sole Practitioner, CPA, satisfies this objective by establishing and maintaining the policies and procedures described in paragraphs 4.16 through 4.19.

4.16 **Policy 1: I consider and evaluate, on an ongoing basis, the relevance and adequacy of my quality control policies and procedures.** Sole Practitioner, CPA, implements this policy by reviewing all policies and procedures and revising those affected by changes in professional standards or the nature of her practice.

4.17 **Policy 2: I consider and evaluate, on an ongoing basis, the appropriateness of my guidance materials and practice aids.** Sole Practitioner, CPA, implements this policy by reviewing and determining that the firm’s practice aids are current and reflect recent professional pronouncements and changes in her practice.

4.18 **Policy 3: I consider and evaluate, on an ongoing basis, the effectiveness of professional development activities.** Sole Practitioner, CPA, implements this policy by:

- Reviewing CPE records to determine whether the classroom training and self-study programs she uses are appropriate for the firm’s practice.
- Reviewing CPE records to determine compliance with the requirements of the AICPA and other applicable regulatory agencies.

4.19 **Policy 4: I consider and evaluate, on an ongoing basis, compliance with my policies and procedures, and with professional standards.** Sole Practitioner, CPA, implements this policy by:

- Performing a postissuance review of selected engagements within six months of the completion of the engagements.\(^3\)
- Including in the postissuance review, engagements for which there have been complaints or allegations from clients or third parties that the work failed to comply with professional standards, regulatory requirements, or the firm’s system of quality control.
- Placing additional emphasis to correct certain deficient areas in future engagements.
- Determining if existing policies and procedures should be modified so that any identified deficiencies do not recur.
- Reviewing compliance with the firm’s policies and procedures related to independence, integrity, and objectivity; personnel management; acceptance and continuance of clients and engagements; and engagement performance.

\(^3\) A postissuance review may be performed as part of an inspection. A sole proprietor may consider engaging another CPA to perform the inspection to obtain a fresh look at the engagement. See paragraph 3.29, “Scenario 2: Reviewing a Sample of Engagements During a Designated Period of the Year,” for a description of how a firm considers and evaluates, on an ongoing basis, compliance with a firm’s policies and procedures by performing an annual inspection.
• Considering the results of the firm’s monitoring and peer review findings to ensure that the competencies necessary to accomplish responsibilities are maintained for each of the firm’s engagements.

• Responding to notification of the need for peer review, scheduling, and completion of peer review on a timely basis, in accordance with professional standards and the requirements of applicable state boards of accountancy.

• Reporting all compilation and review engagements to the firm’s peer reviewer.

• Demonstrating compliance with the monitoring element of quality control by summarizing the results of the procedures in paragraphs 4.15 through 4.19 as they relate to the firm’s quality control policies and procedures. Although the form and content of that documentation is a matter of judgment, the illustration in paragraph 4.20 is an example of such documentation.

4.20

**Table 1** Summary of Quality Control Monitoring System For the Calendar Year 200X

<table>
<thead>
<tr>
<th>Element of Quality Control and Applicable Policies</th>
<th>Reviewer's Initials and Date Reviewed</th>
<th>Location of Additional Documentation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Independence, integrity, and objectivity</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Policy 1. Adhering to applicable independence, integrity, and objectivity requirements such as those in regulations, interpretations, and rules of the AICPA, state CPA societies, state boards of accountancy, state statutes, and other applicable regulators.</td>
<td>JB 6/30/0X</td>
<td>Independence confirmation files</td>
</tr>
<tr>
<td>Policy 2. Establishing procedures to help mitigate possible threats to my independence and objectivity.</td>
<td>JB 6/30/0X</td>
<td>Independence confirmation files</td>
</tr>
<tr>
<td><strong>Personnel management</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Policy 1. Maintaining the knowledge, skills, and abilities required in the circumstances by participating in general and industry-specific continuing professional education (CPE) and professional development activities that should enable me to accomplish my responsibilities and satisfy applicable CPE requirements of the AICPA, state CPA society, state boards of accountancy, and other applicable regulators. Also, monitoring for compliance the CPE requirements of per diem employees.</td>
<td>JB 6/30/0X</td>
<td>Personnel files</td>
</tr>
</tbody>
</table>
Element of Quality Control and Applicable Policies | Reviewer’s Initials and Date Reviewed | Location of Additional Documentation
--- | --- | ---
Acceptance and continuance of clients and engagements
- Policy 1. Evaluating factors that have a bearing on management’s integrity. JB 6/30/0X Client acceptance files and client engagement files
- Policy 2. Accepting or continuing to perform only those engagements I can complete with professional competence, and appropriately considering the risk associated with providing professional services in particular circumstances. JB 6/30/0X Engagement files
- Policy 3. Establishing an understanding with the client regarding services to be performed. JB 6/30/0X Engagement files

Engagement performance
- Policy 1. Planning engagements to meet professional standards and the firm’s requirements. JB 6/30/0X Engagement files
- Policy 2. Performing, supervising, reviewing, documenting, and reporting (or communicating) in accordance with the requirements of professional standards and the firm. JB 6/30/0X Engagement files
- Policy 3. Identifying areas and specialized situations for which consultation is necessary, and requiring personnel to refer to authoritative literature and practice aids, and consult, on a timely basis, with individuals outside the firm when appropriate. JB 6/30/0X Engagement files

Monitoring
- Policy 1. Considering and evaluating, on an ongoing basis, the relevance and adequacy of my quality control policies and procedures. JB 6/30/0X Inspection/monitoring file
- Policy 2. Considering and evaluating, on an ongoing basis, the appropriateness of my guidance materials and practice aids. JB 6/30/0X Inspection/monitoring file
- Policy 3. Considering and evaluating, on an ongoing basis, the effectiveness of professional development activities. JB 6/30/0X Inspection/monitoring file
- Policy 4. Considering and evaluating, on an ongoing basis, compliance with my policies and procedures, and with professional standards. JB 6/30/0X Inspection/monitoring file
5.01 An alternative practice structure, as referred to in this Practice Aid, is a nontraditional structure in the practice of public accounting that contains an attest and a nonattest portion. Alternative practice structures are described in Interpretation 101-14, “The effect of alternative practice structures on the applicability of independence rules,” under Rule 101, Independence (AICPA, Professional Standards, vol. 2, ET sec. 101.16), and is included as Appendix C of this Practice Aid. The closely aligned CPA Firm has no Securities and Exchange Commission (SEC) clients.

This chapter describes quality control policies and procedures relevant to alternative practice structures when certain portions of the CPA firm’s system of quality control:

- Reside at the **non-CPA-owned entity**, or
- Operate in conjunction with the system of quality control of the non-CPA-owned entity.

Elements of quality control that might reside in a non-CPA-owned entity include:

- Independence, integrity, and objectivity requirements.
- Personnel management.
- Monitoring.

This chapter describes quality control policies and procedures that should reside in the non-CPA-owned entity or its affiliated companies, and are related to:

- Independence, integrity, and objectivity
- Personnel management.
- The monitoring of independence, integrity, objectivity, and personnel management.

These quality control policies and procedures are in addition to those that might reside in a closely aligned CPA firm that may or may not perform audit services for issuers.

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1 If the closely aligned CPA firm were to be engaged to perform audit services for an issuer, the non-CPA-owned entity or its affiliated companies might need to revise their quality control policies and procedures to comply with Public Company Accounting Oversight Board (PCAOB) standards and to reflect Securities and Exchange Commission (SEC) requirements applicable to audits of issuers.
INDEPENDENCE, INTEGRITY, AND OBJECTIVITY

5.02 The objective of the independence, integrity, and objectivity element of a system of quality control is to provide the firm with reasonable assurance that personnel maintain independence (in fact and in appearance) in all required circumstances, perform all professional responsibilities with integrity, and maintain objectivity in discharging professional responsibilities. A CPA firm that is closely aligned with a non-CPA-owned entity satisfies this objective by ensuring that the non-CPA-owned entity establishes and maintains the policies and procedures described in paragraphs 5.03 to 5.05.

5.03 Policy 1: The non-CPA-owned entity adheres to applicable independence, integrity, and objectivity requirements such as those in regulations, interpretations, and rules of the AICPA, state CPA societies, state boards of accountancy, state statutes, and other applicable regulators. The non-CPA-owned entity implements this policy by:

- Developing policies and procedures to ensure the independence of the CPA firm as required by the applicable aforementioned regulators. (The non-CPA entity is required to be independent only in the context of its alignment with the CPA firm; it does not perform any attest functions, so its independence is not relevant.)

- Designating an officer to be responsible for providing guidance, answering questions, monitoring compliance, and resolving matters concerning independence, integrity, and objectivity of the CPA firm.

- Determining when consultation with outside sources regarding independence, integrity, and objectivity matters is required.

- Reviewing written representations from direct and indirect superiors and others as applicable, and resolving potential independence, integrity, and objectivity matters.

- Maintaining documentation of the resolution of independence, integrity, and objectivity matters.

- Requiring entity personnel to obtain sufficient training and education to accomplish their responsibilities with respect to independence, integrity, and objectivity.

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2 Direct superiors are defined to include those persons so closely associated with a partner or manager who is a covered member, that such persons can directly control the activities of such partner or manager. For this purpose, a person who can directly control is the immediate superior of the partner or manager who has the power to direct the activities of that person so as to be able to directly or indirectly (for example, through another entity over which the direct superior can exercise significant influence) derive a benefit from that person’s activities. Examples would be the person who has day-to-day responsibility for the activities of the partner or manager and is in a position to recommend promotions and compensation levels. Indirect superiors are those persons who are one or more levels above direct superiors. Generally, this would start with persons in an organization structure to whom direct superiors report and go up the line from there.
• Obtaining from the CPA firm a current list of all entities with which firm personnel are prohibited from having a business relationship.  

• Obtaining written representations from personnel of the non-CPA-owned entity, upon hire and on an annual basis, stating that they are familiar with and in compliance with the non-CPA-owned entity’s policies and procedures regarding independence, integrity, and objectivity.

5.04 **Policy 2: Personnel of the non-CPA-owned entity are familiar with policies and procedures regarding independence, integrity, and objectivity.** The non-CPA-owned entity implements this policy by:

• Providing all of its personnel with access to its policies and procedures and guidance materials related to independence, integrity, and objectivity, for example, manuals, memoranda, and databases containing professional and regulatory literature.

• Advising personnel of the non-CPA-owned entity that the following financial or other relationships, circumstances, or activities involving either individuals or entities may be prohibited:

  — Business relationships with the CPA firm’s clients or with non-clients that have investor or investee relationships with the CPA firm’s clients.

  — Loans to and from the CPA firm’s clients, including loans from the CPA firm’s financial-institution clients.

  — Family members who are employed by the CPA firm’s clients, or who serve as director, officer, manager, or in other audit-sensitive positions with clients of the CPA firm, including not-for-profit organizations.

  — Past due fees from the CPA firm’s clients.

  — Services in which the service provider assumes some of the responsibilities of client management.

  — Performing bookkeeping services for Securities and Exchange Commission (SEC) clients of the CPA firm.

  — Client relationships with the non-CPA-owned entity in which the CPA firm leases employees, facilities, and so on.

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3 Examples of business relationships prohibited by independence standard-setting bodies such as the AICPA, U.S. Government Accountability Office (GAO; formerly the General Accounting Office), and U.S. Department of Labor (DOL) because they might impair independence include being an investor in a joint venture with a client, or serving as a board member on the board of an audit client.
— Situations in which personnel of the non-CPA-owned entity act as promoters, underwriters, voting trustees, directors, or officers of the CPA firm’s clients.

— Direct and material financial interests in clients of the CPA firm.

— Material investments by the CPA firm’s clients in the non-CPA-owned entity that allow the clients to exercise significant influence over the non-CPA-owned entity.

• Advising personnel of the non-CPA-owned entity during professional development meetings, in memoranda, or in electronic communications of:

  — All direct superiors, and all activities in which the firm is prohibited from engaging, as defined in the firm’s independence policies and procedures.⁴

  - All indirect superiors, and all activities in which the firm is prohibited from engaging, as defined by the non-CPA-owned entity’s policies and procedures.

• Obtaining client lists from the CPA firm to inform all personnel, on a timely basis, of clients of the CPA firm to which independence policies apply.

• Obtaining documented representations from all non-CPA-entity personnel, including those defined as direct and indirect superiors or supervisors of affiliated issuers,⁵ upon hire and on an annual basis thereafter, stating that they are familiar with and in compliance with policies and procedures regarding independence, integrity, and objectivity.

• Assigning responsibility for obtaining, maintaining, and reviewing those representations for completeness, and resolving reported exceptions with the non-CPA-owned entity’s chief executive.

• Requiring the chief executive of the non-CPA-owned entity to review unpaid fees from clients of the CPA firm to ascertain whether any outstanding amounts impair the CPA firm’s independence.

5.05 Policy 3: The top-tier company⁶ maintains a system of quality control to ensure that its personnel and indirect superiors⁷ adhere to all applicable independence, integrity, and objectivity requirements, such as those in regulations, interpretations, and rules of the

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⁴ Examples of business relationships prohibited by independence standard-setting bodies such as the AICPA, GAO, and DOL because they might impair independence include being an investor in a joint venture with a client that is material to the client, or serving as a board member on the board of an audit client. Examples of prohibited activities include providing certain valuation and information technology services to an audit client. Readers should refer to the rules of specific standard-setters to determine the extent and relevance of any prohibition.

⁵ Affiliated issuers include the top-tier company and all entities consolidated in the top-tier company’s financial statements. Individuals in these entities are not in situations in which a direct superior can exercise significant influence.

⁶ The top-tier company is the parent company of the non-CPA-owned entity, which may be an issuer.

⁷ Indirect superiors generally are involved in regional management of direct superiors; thus, they need to adhere to requirements.
**AICPA, state CPA societies, state boards of accountancy, state statutes, and other applicable regulators.** The non-CPA-owned entity implements this policy by:

- Designating an individual to be responsible for:
  - Designing and directing the quality control activities at the top-tier company and disseminating information to all subsidiaries and affiliated entities, all subsidiaries associated with CPA firms, and all CPA firms closely aligned with company subsidiaries.
  - Maintaining documentation of the resolution of all independence, integrity, and objectivity questions.
  - Identifying significant shareholders qualifying as indirect superiors, and obtaining a comprehensive list of entities with which the indirect superiors are associated.
  - Comparing the names of the indirect superiors and their associated entities with the list of attest clients of CPA firms closely aligned with company subsidiaries to ensure that such individuals or associated companies are not receiving attest services from associated CPA firms.
  - Ensuring that indirect superiors review lists of all attest clients of CPA firms closely aligned with company subsidiaries, and represent their independence.
  - Reviewing all independence representations and resolving conflicts noted on those representations.
- Providing all company personnel and indirect superiors with access to the company’s policies and procedures with respect to independence, integrity, and objectivity.
- Maintaining a database, accessible to all company personnel including direct and indirect superiors, of affiliated issuers and clients of CPA firms that are issuers and are closely aligned with the company or its subsidiaries.
- Obtaining written representations from all **leased or per diem personnel** and indirect superiors of companies that provide leased or per diem personnel, upon hire and on an annual basis, stating that they are familiar with and in compliance with the non-CPA-owned entity’s policies and procedures regarding independence, integrity, and objectivity and that they are independent with respect to the associated CPA firm’s attest clients.
- Providing the CPA firm with a representation that all leased or per diem personnel and indirect superiors are independent with respect to the CPA firm’s attest clients.

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8 Leased or per diem personnel are professional personnel who devote at least 25 percent of their time to performing attest engagements, or who have partner- or manager-level responsibility for the overall supervision or review of such engagements.
5.06 The objective of the personnel management element of a system of quality control is to provide the non-CPA-owned entity with reasonable assurance that leased or per diem personnel have the characteristics that will enable them to competently perform their assigned responsibilities for the CPA firm. Attributes or qualities that enhance the capability of personnel who perform, supervise, or review work include integrity, objectivity, intelligence, judgment, competence, experience, and motivation. A CPA firm closely aligned with a non-CPA-owned entity satisfies this objective by ensuring that the non-CPA-owned entity establishes and maintains the policies and procedures described in paragraphs 5.07 through 5.09 with regard to its leased or per diem personnel.

5.07 Policy 1: Leased or per diem personnel possess characteristics that enable them to competently perform and review engagements. The non-CPA-owned entity implements this policy by:

- Designating an individual to be responsible for hiring and managing human resources on behalf of the CPA firm.
- Reviewing the CPA firm’s personnel requirements for attest engagements to ensure that sufficient and capable staff persons are available to perform those engagements.
- Establishing criteria for hiring professionals on behalf of the CPA firm that include the attributes, achievements, and experiences desired in entry-level and experienced personnel. Such criteria should assist in evaluating (a) the personal characteristics of professionals, such as, integrity, competence, and motivation, and (b) whether professionals can competently perform responsibilities within the CPA firm. Guidelines should be established for the additional procedures to be performed when hiring experienced personnel, such as performing background checks and inquiring about any outstanding regulatory actions.
- Establishing criteria for determining which individuals will be involved in interviewing and hiring personnel on behalf of the CPA firm.

5.08 Policy 2: Leased or per diem personnel participate in general and industry-specific continuing professional education (CPE) and other professional activities that enable them to accomplish assigned responsibilities and satisfy applicable CPE requirements of the AICPA, state CPA societies, state accountancy boards, and other regulatory agencies. The non-CPA-owned entity implements this policy by:

- Designating an individual to be responsible for CPE and professional development activities, including maintaining CPE records and course material for leased and per diem personnel.
• Establishing policies that require individuals performing audits, reviews, compilations, or attestation engagements for the CPA firm to participate in CPE related to accounting and auditing.

• Establishing policies requiring all leased or per diem personnel to be in compliance with the professional education requirements of the boards of accountancy in states where they are licensed, and with the AICPA, state societies, and other regulatory agencies, as applicable.

• Establishing an orientation and training policy for new hires who will devote at least 25 percent of their time to performing audits, reviews, compilations, or attestation engagements for the CPA firm, or who will have partner- or manager-level responsibility for the overall supervision or review of such engagements.

• Ensuring that leased or per diem personnel are informed about changes in accounting and auditing standards, independence, integrity, and objectivity requirements, and the CPA firm’s technical policies and procedures that are relevant to them.

• Encouraging leased or per diem personnel to participate in other professional activities, such as graduate-level courses, membership in professional organizations, and serving on professional committees.

5.09 Policy 3: Leased or per diem personnel who are selected for advancement have the qualifications to accomplish the responsibilities they will be called upon to assume. Factors to consider include the degree of technical training and proficiency required in the circumstances, and the nature and extent of supervision of assignments relating to audits, reviews, compilations, or attestation engagements performed by the CPA firm. The non-CPA-owned entity implements this policy by:

• Establishing a system for providing information to the CPA firm so that it can make appropriate personnel decisions, such as assignments for audits, reviews, compilations, and attestation engagements.

• Designating an individual to be responsible for:
  — Establishing criteria for the evaluation and advancement of leased or per diem personnel, including appropriate documentation.
  — Making advancement and termination decisions, including identifying responsibilities and requirements for evaluation at each professional level, and deciding who will prepare those evaluations.
  — Developing appropriate evaluation forms.
  — Reviewing performance evaluations with personnel, discussing future objectives of the CPA firm and the individual, and discussing assignment preferences.
— Periodically evaluating owners of the CPA firm by means of peer evaluation or self-appraisal.

— Counseling leased or per diem personnel regarding their progress and career opportunities.

• Establishing an arrangement with the CPA firm in which a supervisory-level individual of the CPA firm is responsible for assisting the non-CPA-owned entity in making advancement and termination decisions concerning leased or per diem personnel. This would include evaluating personnel needs, establishing hiring objectives, and providing final approval.

• Developing a system for evaluating the performance of leased or per diem personnel and advising them of their progress.

**Monitoring**

5.10 The objective of the monitoring element of a system of quality control is to provide the firm with reasonable assurance that the policies and procedures relating to the other elements of quality control are suitably designed and effectively applied. Monitoring is an ongoing consideration and evaluation process. A CPA firm closely aligned with a non-CPA-owned entity satisfies this objective by ensuring that the non-CPA-owned entity establishes and maintains the policies and procedures described in paragraphs 5.11 and 5.12.

5.11 **Policy 1:** The non-CPA-owned entity considers and evaluates, on an ongoing basis, the relevance and adequacy of its policies and procedures related to independence, integrity, and objectivity which are applicable to all its personnel, and its personnel management policies and procedures applicable to leased or per diem personnel. The non-CPA-owned entity implements this policy by designating qualified individuals to be responsible for monitoring quality assurance, including:

• Ensuring that the non-CPA-owned entity’s quality control guidance is regularly updated to reflect changes in professional standards related to independence, CPE, and other regulatory requirements by:

  — Implementing a system of ongoing monitoring of the effectiveness and appropriateness of policies and procedures related to independence, objectivity, and integrity as applicable to all personnel of the non-CPA-owned entity and compliance with those policies and procedures.

  — Ensuring, on an ongoing basis, that guidance materials and any practice aids the non-CPA-owned entity provides to the CPA firm are appropriately designed to assist the CPA firm in adhering to quality control standards.
— Maintaining a system to ensure that the practice aids regarding independence and other technical matters provided by the non-CPA-owned entity are updated to reflect current professional standards and regulatory requirements, and are relevant to and effective for the CPA firm’s practice.

— Ensuring that the non-CPA-owned entity informs and provides guidance to leased or per diem personnel regarding new professional standards, regulatory requirements, and related changes to relevant CPA firm policies or practice aids.

5.12 Policy 2: The non-CPA-owned entity considers and evaluates, on an ongoing basis, compliance with its policies and procedures related to independence, integrity, and objectivity which are applicable to all of its personnel, as well as personnel management policies and procedures applicable to leased or per diem personnel. The non-CPA-owned entity implements this policy by having the designated qualified individuals responsible for monitoring:

• Consider and evaluate, on an ongoing basis, compliance with policies and procedures related to independence, integrity, and objectivity, as applicable to all of its personnel, by:

  — Performing timely monitoring of policies and procedures, on an on-going basis, relating to independence, integrity, and objectivity to evaluate compliance with those policies and procedures. The monitoring policies and procedures could include an internal audit function, ongoing review by senior management, or engaging an independent CPA to examine and report on compliance.

  — Summarizing and communicating the results of the monitoring to all of its personnel, and communicating any suggested changes to policies and procedures to the appropriate levels of personnel in the non-CPA-owned entity.

  — Correcting noted deficiencies based on the results of the monitoring to ensure compliance with policies and procedures.

• Engage an independent CPA to report on whether the top-tier company complied with its system of quality control with respect to its policies and procedures for independence, integrity, and objectivity. This engagement should be an attestation engagement performed annually under Chapter 1, “Attest Engagements,” of Statement on Standards for Attestation Engagements No. 1, Attestation Standards: Revision and Recodification (AICPA, Professional Standards, vol. 1, AT sec. 101), as revised. See Policy 3 in paragraph 5.05 for information about quality control policies and procedures at the top-tier firm.
accounting and auditing practice (attest practice). A practice that performs audit, attest, compilation, review, and any other services for which standards have been established by the AICPA Auditing Standards Board or the AICPA Accounting and Review Services Committee under Rules 201 or 202 of the AICPA Code of Professional Conduct (AICPA, Professional Standards, vol. 2, ET secs. 201 and 202). Although standards for other engagements may be established by other AICPA technical committees, engagements performed in accordance with those standards are not encompassed in the definition of an accounting and auditing practice.

firm. A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the American Institute of Certified Public Accountants that is engaged in the practice of public accounting. Except for purposes of applying Rule 101: Independence, the firm includes the individual partners thereof.

foreign-associated firm. A firm domiciled outside of the United States and its territories that is a member of, correspondent with, or similarly associated with an international firm or international association of firms.

issuer. Paragraph 7 of Section 2, “Definitions,” of the Sarbanes-Oxley Act of 2002 states, “The term ‘issuer’ means an issuer (as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c)), the securities of which are registered under section 12 of that Act (15 U.S.C. 78l), or that is required to file reports under section 15(d) (15 U.S.C. 78o(d)), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a et seq.), and that it has not withdrawn.”

partner. A proprietor, shareholder, equity, or non-equity partner or any individual who assumes the risks and benefits of firm ownership or who is otherwise held out by the firm to be the equivalent of any of the aforementioned.

personnel. All individuals who perform professional services for which the firm is responsible, whether or not they are CPAs.

policy. A definite course or method of action to guide and determine present and future decisions. It is a guide to decision making under a given set of circumstances within the framework of a firm’s objectives, goals, and management philosophies.

practitioner-in-charge. An individual who is responsible for supervising accounting, auditing, and attestation engagements and signing or authorizing an individual to sign the accountant’s report on such engagements.
procedure. A particular way of accomplishing something, an established way of doing things, a series of steps followed in a definite regular order. It provides for a consistent and repetitive approach to actions.

Terms Related to Alternative Practice Structures

For additional information about these terms, see Interpretation No. 101-14 of Rule 101, Independence, “The Effect of Alternative Practice Structures on the Applicability of Independence Rules” (AICPA, Professional Standards, vol. 2, ET sec. 101.16), reprinted in Appendix C of this Practice Aid.

alternative practice structure. A nontraditional structure in the practice of public accounting consisting of an attest and a nonattest portion of the practice. The attest portion is conducted through a firm owned and controlled by CPAs. The nonattest portion is conducted through a separate issuer or nonissuer firm owned and controlled by individuals who are not CPAs.

direct superiors. Those persons so closely associated with a partner or manager who is a covered member,¹ that such persons can directly control the activities of such partner or manager. For this purpose, a person who can directly control is the immediate superior of the partner or manager who has the power to direct the activities of that person so as to be able to directly or indirectly (for example, through another entity over which the direct superior can exercise significant influence) derive a benefit from that person’s activities. Examples would be the person who has day-to-day responsibility for the activities of the partner or manager and is in a position to recommend promotions and compensation levels.

indirect superiors. Those persons who are one or more levels above direct superiors. Generally, this would start with persons in an organization structure to whom direct superiors report and go up the line from there.

¹ The term covered member is defined in AICPA Code of Professional Conduct, “Definitions,” (AICPA, Professional Standards, vol. 2, ET sec. 92.06). A covered member is:

a. An individual on the attest engagement team;
b. An individual in a position to influence the attest engagement;
c. A partner or manager who provides nonattest services to the attest client beginning once he or she provides ten hours of nonattest services to the client within any fiscal year and ending on the later of the date (i) the firm signs the report on the financial statements for the fiscal year during which those services were provided or (ii) he or she no longer expects to provide ten or more hours of nonattest services to the attest client on a recurring basis;
d. A partner in the office in which the lead attest engagement partner primarily practices in connection with the attest engagement;
e. The firm, including the firm’s employee benefit plans; or
f. An entity whose operating, financial, or accounting policies can be controlled (as defined by generally accepted accounting principles [GAAP] for consolidation purposes) by any of the individuals or entities described in (a) through (e) or by two or more such individuals or entities if they act together.
leased or per diem personnel. Professional personnel who devote at least 25 percent of their time to attest functions, or who have partner- or manager-level responsibility for the overall supervision or review of attest engagements.

nonattest portion of the practice. All services other than audit, attest, compilation, review, and other services performed under standards established by the AICPA Auditing Standards Board or the AICPA Accounting and Review Services Committee pursuant to Rules 201 or 202 of the AICPA Code of Professional Conduct.

non-CPA-owned entity. An entity with which a CPA firm is closely aligned through common employment, leasing of employees, equipment, facilities, or other similar arrangements.

top-tier company. The parent company of a non-CPA-owned entity, which may be an issuer.
APPENDIX B: STATEMENTS ON QUALITY CONTROL STANDARDS

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.

STATEMENT ON QUALITY CONTROL STANDARDS NO. 2, SYSTEM OF QUALITY CONTROL FOR A CPA FIRM’S ACCOUNTING AND AUDITING PRACTICE (AICPA, PROFESSIONAL STANDARDS, VOL. 2, QC SEC. 20), AS AMENDED

(Supersedes Statement on Quality Control Standards No. 1 and its Interpretations)

Introduction and Applicability

.01  This Statement 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 Statement provides that a CPA firm shall have a system of quality control for its accounting and auditing practice.2

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 (AICPA, Professional Standards, vol. 2, ET secs. 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.
System of Quality Control

.03 A firm\(^3\) has a responsibility to ensure that its personnel\(^4\) comply with the 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.\(^5\) 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.

.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:

\(^3\) 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” (AICPA, Professional Standards, vol. 2, ET sec. 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.

\(^5\) Deficiencies in individual audit, attest, review, and compilation engagements do not, in and of themselves, indicate that the firm’s system of quality control is insufficient to provide it with reasonable assurance that its personnel comply with applicable professional standards.
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, perform all professional responsibilities with integrity, and maintain objectivity in discharging professional responsibilities.

.10 Independence, Integrity, and Objectivity are defined and more fully described in the AICPA Code of Professional Conduct (the Code) and AICPA Professional Standards, vol. 1, AU section 220, Independence. Rules 101 and 102 of the Code, and the related Interpretations and Rulings (AICPA, Professional Standards, vol. 2, ET secs. 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. Integrity requires personnel to be honest and candid within the constraints of client confidentiality. Service and the public trust should not be subor-

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6 Independence requirements are set forth in Rule 101 of the AICPA Code of Professional Conduct (AICPA, Professional Standards, vol. 2, ET sec. 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 [now the U.S. Government Accountability Office], and the U.S. Department of Labor.

7 See AICPA, Professional Standards, vol. 1, AU section 220.02.
ominated 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.8

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 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,

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8 Regulatory agencies that have established continuing education requirements include state boards of Accountancy and the U.S. General Accounting Office [now the U.S. Government Accountability Office].
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. Where applicable, these policies and procedures should also address the concurring partner review requirements applicable to SEC engagements as set forth in membership requirements of the SEC Practice Section of the AICPA.

.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. 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.

**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.

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Appendix B: Statements on Quality Control Standards

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 Statement are applicable to a CPA firm’s system of quality control for its accounting and auditing practice as of January 1, 1997.
STATEMENT ON QUALITY CONTROL STANDARDS NO. 3, MONITORING A CPA FIRM’S ACCOUNTING AND AUDITING PRACTICE (AICPA, PROFESSIONAL STANDARDS, VOL. 2, QC SEC. 30)

Introduction

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

.02 Statement on Quality Control Standards No. 2, 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 (AICPA, Professional Standards, vol. 2, ET secs. 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” (AICPA, Professional Standards, vol. 2, ET sec. 92.05).
Appendix B: Statements on Quality Control Standards

- 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 reviews\(^4\) and previous inspection procedures.
- Appropriate cost-benefit considerations.\(^5\)

\(^3\) 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.
.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.
- 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 individuals\(^6\) 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.

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\(^6\) 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 (AICPA, Professional Standards, vol. 2, ET. sec. 101.11).
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 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 Statement are applicable to a CPA firm’s system of quality control for its accounting and auditing practice as of January 1, 1997.
STATEMENT ON QUALITY CONTROL STANDARDS NO. 5, THE PERSONNEL MANAGEMENT ELEMENT OF A FIRM’S SYSTEM OF QUALITY CONTROL—COMPETENCIES REQUIRED BY A PRACTITIONER-IN-CHARGE OF AN ATTEST ENGAGEMENT (AICPA, PROFESSIONAL STANDARDS, VOL. 2, QC SEC. 40)

Introduction

.01 Statement on Quality Control Standards No. 2, System of Quality Control for a CPA Firm’s Accounting and Auditing Practice (AICPA, Professional Standards, vol. 2, QC sec. 20), provides that a CPA firm shall have a system of quality control for its accounting and auditing practice that 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

The Personnel Management Element of Quality Control

.02 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. Examples of such characteristics may include meeting minimum academic requirements established by the firm, maturity, integrity, and leadership traits.
- b. Work is assigned to personnel having the degree of technical training and proficiency required in the circumstances.

1 Accounting and auditing practice refers to all accounting, audit, and attestation 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 (AICPA, Professional Standards, vol. 2, ET secs. 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, auditing, and attestation practice.
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.2

d. Personnel selected for advancement have the qualifications necessary for fulfillment of the responsibilities they will be called on to assume.

.03 This Statement clarifies the requirements of the personnel management element of a firm’s system of quality control. In light of the significant responsibilities during the planning and performance of accounting, auditing, and attestation engagements of individuals who are responsible for supervising accounting, auditing, and attestation engagements and signing or authorizing an individual to sign the accountants report on such engagements, a firm’s policies and procedures related to the items noted in paragraph .02 above should be designed to provide a firm with reasonable assurance that such individuals possess the kinds of competencies that are appropriate given the circumstances of individual client engagements. For purposes of this standard, such an individual is referred to as the practitioner-in-charge of the engagement.

**Competencies**

.04 Competencies are the knowledge, skills, and abilities that enable a practitioner-in-charge to be qualified to perform an accounting, auditing, or attestation engagement. A firm is expected to determine the kinds of competencies that are necessary in the individual circumstances. Competencies are not measured by periods of time because such a quantitative measurement may not accurately reflect the kinds of experiences gained by a practitioner in any given time period. Accordingly, for purposes of this Statement, a measure of overall competency is qualitative rather than quantitative.

**Gaining Competencies**

.05 A firm’s policies and procedures would ordinarily require a practitioner-in-charge of an engagement to gain the necessary competencies through recent experience in accounting, auditing, and attestation engagements. In some cases, however, a practitioner-in-charge will have obtained the necessary competencies through disciplines other than the practice of public accounting, such as in relevant industry, governmental, and academic positions. If necessary, the experience of the practitioner-in-charge should be supplemented by continuing professional education (CPE) and consultation. The following are examples.

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2 Regulatory agencies that have established continuing education requirements include state boards of accountancy and the U.S. General Accounting Office [now the U.S. Government Accountability Office].
Appendix B: Statements on Quality Control Standards

- A practitioner-in-charge of an engagement whose recent experience has consisted primarily in providing tax services may acquire the competencies necessary in the circumstances to perform a compilation or review engagement by obtaining relevant CPE.

- A practitioner-in-charge of an engagement who did not have any experience in auditing the financial statements of a public company and only possessed recent prior experience in auditing the financial statements of nonpublic entities may develop the necessary competencies by obtaining relevant CPE related to SEC rules and regulations and consulting with other practitioners who possess relevant knowledge related to SEC rules and regulations.

- A practitioner-in-charge of an engagement who did not have any experience in auditing the financial statements of a public company but possessed prior public accounting practice experience auditing financial statements of nonpublic entities and who also has relevant experience as the controller of a public company may have the necessary competencies in the circumstances.

- A practitioner-in-charge of an engagement whose actual experience consists of performing review and compilation engagements may be able to obtain the necessary competencies to perform an audit by becoming familiar with the industry in which the client operates, obtaining continuing professional education relating to auditing, and/or using consulting sources during the course of performing the audit engagement.

- A person in academia might obtain the necessary competencies to perform accounting, auditing or attestation engagements by (a) obtaining specialized knowledge through teaching or authorship of research projects or similar papers, and (b) a rigorous self-study program or by engaging a consultant to assist on such engagements.

Regardless of the manner in which a particular competency is gained, a firm’s quality control policies and procedures should be adequate to provide reasonable assurance that a practitioner-in-charge of an engagement possesses the competencies necessary to fulfill his or her engagement responsibilities.

The nature and extent of competencies established by a firm that are expected of the practitioner-in-charge of an engagement should be based on the characteristics of a particular client, industry, and the kind of service being provided. For example, the following should be considered.

- The competencies expected of a practitioner-in-charge of an engagement to compile financial statements would be different than those expected of a practitioner engaged to review or audit financial statements.
• Supervising engagements and signing or authorizing others to sign reports for clients in certain industries or engagements, such as financial services, governmental, or employee benefit plan engagements, would require different competencies than what would be expected in performing attest services for clients in other industries.

• The practitioner-in-charge of an engagement to audit the financial statements of a public company would be expected to have certain technical proficiency in SEC reporting requirements, while a practitioner-in-charge who is not assigned to the audits of public companies would not need to be proficient in this area. This would include, for example, experience in the industry and appropriate knowledge of SEC and ISB rules and regulations, including accounting and independence standards.

• The practitioner-in-charge of an attestation engagement to examine management’s assertion about the effectiveness of an entity’s internal control over financial reporting would be expected to have certain technical proficiency in understanding and evaluating the effectiveness of controls, while a practitioner-in-charge of an attestation engagement to examine investment performance statistics would be expected to have different competencies, including an understanding of the subject matter of the underlying assertion.

**Competencies Expected in Performing Accounting, Auditing, and Attestation Engagements**

.08 In practice, the kinds of competency requirements that a firm should establish for the practitioner-in-charge of an engagement are necessarily broad and varied in both their nature and number. However, the firm’s quality control policies and procedures should ordinarily address the following competencies for the practitioner-in-charge of an engagement. Firms policies and procedures should also address other competencies as necessary in the circumstances.

a. **Understanding of the Role of a System of Quality Control and the Code of Professional Conduct**—Practitioners-in-charge of an engagement should possess an understanding of the role of a firm’s system of quality control and the AICPA’s Code of Professional Conduct, both of which play critical roles in assuring the integrity of the various kinds of accountant’s reports.

b. **Understanding of the Service to be Performed**—Practitioners-in-charge of an engagement should possess an understanding of the performance, supervision, and reporting aspects of the engagement, which is normally gained through actual participation in that kind of engagement under appropriate supervision.

c. **Technical Proficiency**—Practitioners-in-charge of an engagement should possess an understanding of the applicable accounting, auditing, and attest professional standards including those standards directly related to the industry in which a client operates and the kinds of transactions in which a client engages.
d. **Familiarity with the Industry**—To the extent required by professional standards applicable to the kind of service being performed, practitioners-in-charge of an engagement should possess an understanding of the industry in which a client operates. In performing an audit or review of financial statements, this understanding would include an industry’s organization and operating characteristics sufficient to identify areas of high or unusual risk associated with an engagement and to evaluate the reasonableness of industry specific estimates.

e. **Professional Judgment**—Practitioners-in-charge of an engagement should possess skills that indicate sound professional judgment. In performing an audit or review of financial statements, such skills would typically include the ability to exercise professional skepticism and identify areas requiring special consideration including, for example, the evaluation of the reasonableness of estimates and representations made by management and the determination of the kind of report necessary in the circumstances.

f. **Understanding the Organization’s Information Technology Systems**—Practitioners-in-charge of an audit engagement should have an understanding of how the organization is dependent on or enabled by information technologies; and the manner in which information systems are used to record and maintain financial information.

**Interrelationship of Competencies and Other Elements of a Firm’s System of Quality Control**

.09 The competencies listed above are interrelated and gaining one particular competency may be related to achieving another. For example, familiarity with the client’s industry interrelates with a practitioner’s ability to make professional judgments relating to the client.

.10 In establishing policies and procedures related to the nature of competencies needed by the practitioner-in-charge of an engagement, a firm may need to consider the requirements of policies and procedures established for other elements of quality control. For example, a firm would consider its requirements related to engagement performance in determining the nature of any competency requirements that assess the degree of technical proficiency necessary in a given set of circumstances.

**The Relationship of the Competency Requirement of the Uniform Accountancy Act to the Personnel Management Element of Quality Control**

.11 The Uniform Accountancy Act (UAA) is a model legislative statute and related administrative rules that the AICPA and the National Association of State Boards of Accountancy (NASBA) designed to provide a uniform approach to the regulation of the accounting profession. CPAs are not required to follow the provisions of the UAA itself but rather the accountancy laws of the individual licensing jurisdictions in the United States governing the practice of public ac-
counting, which may have adopted the UAA in whole or in part. The UAA provides that “any individual licensee who is responsible for supervising attest or compilation services and signs or authorizes someone to sign the accountant’s report on the financial statements on behalf of the firm shall meet the competency requirements set out in the professional standards for such services.” A firm’s compliance with this Statement is intended to enable a practitioner who performs the services described in the preceding sentence on the firm’s behalf to meet this competency requirement; however, this Statement’s applicability is broader than what is required by the UAA since the definition of an accounting and auditing practice in quality control standards encompasses a wider range of attest engagements.

**Effective Date**

.12 The provisions of this Statement are applicable to a CPA firm’s system of quality control for its accounting and auditing practice as of June 30, 2000. Earlier implementation is encouraged.
APPENDIX C: INTERPRETATION 101-14 OF RULE 101

INTERPRETATION 101-14 OF RULE 101, INDEPENDENCE: THE EFFECT OF ALTERNATIVE PRACTICE STRUCTURES ON THE APPLICABILITY OF INDEPENDENCE RULES (AICPA, PROFESSIONAL STANDARDS, VOL. 2, ET SEC. 101.16)

Because of changes in the manner in which members* are structuring their practices, the AICPA’s professional ethics executive committee (PEEC) studied various alternatives to “traditional structures” to determine whether additional independence requirements are necessary to ensure the protection of the public interest.

In many “nontraditional structures,” a substantial (the nonattest) portion of a member’s practice is conducted under public or private ownership, and the attest portion of the practice is conducted through a separate firm owned and controlled by the member. All such structures must comply with applicable laws, regulations, and Rule 505, Form of Organization and Name [ET section 505.01]. In complying with laws, regulations, and rule 505 [ET section 505.01], many elements of quality control are required to ensure that the public interest is adequately protected. For example, all services performed by members and persons over whom they have control must comply with standards promulgated by AICPA Council-designated bodies, and, for all other firms providing attest services, enrollment is required in an AICPA-approved practice-monitoring program. Finally, and importantly, the members are responsible, financially and otherwise, for all the attest work performed. Considering the extent of such measures, PEEC believes that the additional independence rules set forth in this interpretation are sufficient to ensure that attest services can be performed with objectivity and, therefore, the additional rules satisfactorily protect the public interest.

Rule 505 [ET section 505.01] and the following independence rules for an alternative practice structure (APS) are intended to be conceptual and applicable to all structures where the “traditional firm” engaged in attest services is closely aligned with another organization, public or private, that performs other professional services. The following paragraph and the chart below provide an example of a structure in use at the time this interpretation was developed. Many of the references in this interpretation are to the example. PEEC intends that the concepts expressed herein be applied, in spirit and in substance, to variations of the example structure as they develop.

* Terms shown in boldface type upon first usage in this interpretation are defined in AICPA, Professional Standards, vol. 2, ET section 92, Definitions.
The example APS in this interpretation is one where an existing CPA practice (“Oldfirm”) is sold by its owners to another (possibly public) entity (“PublicCo”). PublicCo has subsidiaries or divisions such as a bank, insurance company or broker-dealer, and it also has one or more professional service subsidiaries or divisions that offer to clients nonattest professional services (e.g., tax, personal financial planning, and management consulting). The owners and employees of Oldfirm become employees of one of PublicCo’s subsidiaries or divisions and may provide those nonattest services. In addition, the owners of Oldfirm form a new CPA firm (“Newfirm”) to provide attest services. CPAs, including the former owners of Oldfirm, own a majority of Newfirm (as to vote and financial interests). Attest services are performed by Newfirm and are supervised by its owners. The arrangement between Newfirm and PublicCo (or one of its subsidiaries or divisions) includes the lease of employees, office space and equipment; the performance of back-office functions such as billing and collections; and advertising. Newfirm pays a negotiated amount for these services.

**APS Independence Rules for Covered Members**

The term **covered member** in an APS includes both employed and leased individuals. The **firm** in such definition would be Newfirm in the example APS. All covered members, including the firm, are subject to rule 101 [ET section 101.01] and its interpretations and rulings in their entirety. For example, no covered member may have, among other things, a direct financial interest in or a loan to or from an attest client of Newfirm.

**Partners** of one Newfirm generally would not be considered partners of another Newfirm except in situations where those partners perform services for the other Newfirm or where there are significant shared economic interests between partners of more than one Newfirm. If, for example, partners of Newfirm 1 perform services in Newfirm 2, such owners would be considered to be partners of both Newfirms for purposes of applying the independence rules.

**APS Independence Rules for Persons and Entities Other Than Covered Members**

As stated above, the independence rules normally extend only to those persons and entities included in the definition of covered member. This normally would include only the “traditional firm” (Newfirm in the example APS), those covered members who own or are employed or leased by Newfirm, and entities controlled by one or more of such persons. Because of the close alignment in many APSs between persons and entities included in covered member and other persons and entities, to ensure the protection of the public interest, PECC believes it appropriate to require restrictions in addition to those required in a traditional firm structure. Those restrictions are divided into two groups:
1. **Direct Superiors.** Direct Superiors are defined to include those persons so closely associated with a partner or manager who is a covered member, that such persons can directly control the activities of such partner or manager. For this purpose, a person who can directly control is the immediate superior of the partner or manager who has the power to direct the activities of that person so as to be able to directly or indirectly (e.g. through another entity over which the Direct Superior can exercise significant influence\(^\text{22}\) derive a benefit from that person’s activities. Examples would be the person who has day-to-day responsibility for the activities of the partner or manager and is in a position to recommend promotions and compensation levels. This group of persons is, in the view of PEEC, so closely aligned through direct reporting relationships with such persons that their interests would seem to be inseparable. Consequently, persons considered Direct Superiors, and entities within the APS over which such persons can exercise significant influence\(^\text{23}\) are subject to rule 101 [ET section 101.01] and its interpretations and rulings in their entirety.

2. **Indirect Superiors and Other PublicCo Entities.** Indirect Superiors are those persons who are one or more levels above persons included in Direct Superior. Generally, this would start with persons in an organization structure to whom Direct Superiors report and go up the line from there. PEEC believes that certain restrictions must be placed on Indirect Superiors, but also believes that such persons are sufficiently removed from partners and managers who are covered persons to permit a somewhat less restrictive standard. Indirect Superiors are not connected with partners and managers who are covered members through direct reporting relationships; there always is a level in between. The PEEC also believes that, for purposes of the following, the definition of Indirect Superior also includes the immediate family of the Indirect Superior.

PEEC carefully considered the risk that an Indirect Superior, through a Direct Superior, might attempt to influence the decisions made during the engagement for a Newfirm attest client. PEEC believes that this risk is reduced to a sufficiently low level by prohibiting certain relationships between Indirect Superiors and Newfirm attest clients and by applying a materiality concept with respect to financial relationships. If the financial relationship is not material to the Indirect Superior, PEEC believes that he or she would not be sufficiently financially motivated to

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\(^{22}\) For purposes of this Interpretation, significant influence means having the ability to exercise significant influence over the financial, operating or accounting policies of the entity, for example by (1) being connected with the entity as a promoter, underwriter, voting trustee, general partner or director, (2) being in a policy-making position such as chief executive officer, chief operating officer, chief financial officer or chief accounting officer, or (3) meeting the criteria in Accounting Principles Board Opinion No. 18 [AC section 182] and its interpretations to determine the ability of an investor to exercise such influence with respect to an entity. The foregoing examples are not necessarily all-inclusive.

\(^{23}\) For purposes of this Interpretation, significant influence means having the ability to exercise significant influence over the financial, operating or accounting policies of the entity, for example by (1) being connected with the entity as a promoter, underwriter, voting trustee, general partner or director, (2) being in a policy-making position such as chief executive officer, chief operating officer, chief financial officer or chief accounting officer, or (3) meeting the criteria in Accounting Principles Board Opinion No. 18 [AC section 182] and its interpretations to determine the ability of an investor to exercise such influence with respect to an entity. The foregoing examples are not necessarily all-inclusive.
attempt such influence particularly with sufficient effort to overcome the presumed integrity, objectivity and strength of character of individuals involved in the engagement.

Similar standards also are appropriate for Other PublicCo Entities. These entities are defined to include PublicCo and all entities consolidated in the PublicCo financial statements that are not subject to rule 101 [ET section 101.01] and its interpretations and rulings in their entirety.

The rules for Indirect Superiors and Other PublicCo Entities are as follows:

A. Indirect Superiors and Other PublicCo Entities may not have a relationship contemplated by interpretation 101-1.A [ET section 101.02] (e.g., investments, loans, etc.) with an attest client of Newfirm that is material. In making the test for materiality for financial relationships of an Indirect Superior, all the financial relationships with an attest client held by such person should be aggregated and, to determine materiality, assessed in relation to the person’s net worth. In making the materiality test for financial relationships of Other PublicCo Entities, all the financial relationships with an attest client held by such entities should be aggregated and, to determine materiality, assessed in relation to the consolidated financial statements of PublicCo. In addition, any Other PublicCo Entity over which an Indirect Superior has direct responsibility cannot have a financial relationship with an attest client that is material in relation to the Other PublicCo Entity’s financial statements.

B. Further, financial relationships of Indirect Superiors or Other PublicCo Entities should not allow such persons or entities to exercise significant influence24 over the attest client. In making the test for significant influence, financial relationships of all Indirect Superiors and Other PublicCo Entities should be aggregated.

C. Neither Other PublicCo Entities nor any of their employees may be connected with an attest client of Newfirm as a promoter, underwriter, voting trustee, director or officer.

D. Except as noted in C above, Indirect Superiors and Other PublicCo Entities may provide services to an attest client of Newfirm that would impair independence if performed by Newfirm. For example, trustee and asset custodial services in the ordinary course of business by a bank subsidiary of PublicCo would be acceptable as long as the bank was not subject to rule 101 [ET section 101.01] and its interpretations and rulings in their entirety.

24 For purposes of this Interpretation, significant influence means having the ability to exercise significant influence over the financial, operating or accounting policies of the entity, for example by (1) being connected with the entity as a promoter, underwriter, voting trustee, general partner or director, (2) being in a policy-making position such as chief executive officer, chief operating officer, chief financial officer or chief accounting officer, or (3) meeting the criteria in Accounting Principles Board Opinion No. 18 [AC section 182] and its interpretations to determine the ability of an investor to exercise such influence with respect to an entity. The foregoing examples are not necessarily all-inclusive.
Other Matters

1. An example, using the chart below, of the application of the concept of Direct and Indirect Superiors would be as follows: The chief executive of the local office of the Professional Services Subsidiary (PSS), where the partners of Newfirm are employed, would be a Direct Superior. The chief executive of PSS itself would be an Indirect Superior, and there may be Indirect Superiors in between such as a regional chief executive of all PSS offices within a geographic area.

2. PEEC has concluded that Newfirm (and its partners and employees) may not perform an attest engagement for PublicCo or any of its subsidiaries or divisions.

3. PEEC has concluded that independence would be considered to be impaired with respect to an attest client of Newfirm if such attest client holds an investment in PublicCo that is material to the attest client or allows the attest client to exercise significant influence over PublicCo.

4. When making referrals of services between Newfirm and any of the entities within PublicCo, a member should consider the provisions of Interpretation 102-2, Conflicts of Interest [ET section 102.03].

Alternative Practice Structure (APS) Model

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For purposes of this Interpretation, significant influence means having the ability to exercise significant influence over the financial, operating or accounting policies of the entity, for example by (1) being connected with the entity as a promoter, underwriter, voting trustee, general partner or director, (2) being in a policy-making position such as chief executive officer, chief operating officer, chief financial officer or chief accounting officer, or (3) meeting the criteria in Accounting Principles Board Opinion No. 18 [AC section 182] and its interpretations to determine the ability of an investor to exercise such influence with respect to an entity. The foregoing examples are not necessarily all-inclusive.