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**White paper: Navigating through the revised AICPA standards for performing and reporting on peer reviews and related interpretations, effective for peer review commencing on or after January 1, 2009, June 16, 2008**

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# **White Paper**

## **Navigating Through the Revised AICPA STANDARDS FOR PERFORMING AND REPORTING ON PEER REVIEWS and Related Interpretations**

Effective for Peer Reviews Commencing on or After January 1, 2009

**June 16, 2008**

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## NOTICE TO READERS

The purpose of this white paper is to assist you in navigating through the enhancements reflected in the revised [AICPA Standards](#) for Performing and Reporting on Peer Reviews (Standards) and Interpretations to the Standards effective for peer reviews commencing on or after January 1, 2009. This paper explains how the changes may affect you as an enrolled firm (including those responsible for the firm's quality control function), peer reviewer, administering entity (including administrators, technical reviewers, report acceptance bodies, and peer review committees), or peer review user, including regulators. It supersedes and replaces the executive summary which had accompanied the exposure draft issued in April 2007.

This paper also provides background and other pertinent information about comments received by the AICPA Peer Review Board (board) from respondents to the exposure draft of the proposed Standards and Interpretations, explains the consideration given to those comments by the board, and describes the rationale behind the board's adoption of various provisions in the final revised Standards and Interpretations.

Because the revised Standards and Interpretations include numerous significant changes from the current versions, and because the presentation format is also significantly different, they are not provided in track changes. This paper serves as a bridge between the current and revised Standards and Interpretations; the incorporated exhibits to this paper summarize the changes. Those reading and relying on this paper are expected to already be knowledgeable about the current Standards, Interpretations, and other guidance issued by the board that might affect the application of the revised Standards and Interpretations.

Although the revised Standards and Interpretations will be effective for peer reviews commencing on or after January 1, 2009, and early implementation will not be allowed for firms currently enrolled in the AICPA Peer Review Program, we urge you to consider the changes as soon as possible. Some of the changes affect your 2009 review scheduling, for which planning could occur in fall 2008. In addition, there is a change regarding independence requirements which could affect how enrolled firms conduct their 2008 monitoring procedures.

This paper is not authoritative. Nor should it be used as a replacement for the revised Standards and Interpretations, which contain detailed critical guidance. The board urges you to carefully read the revised Standards and Interpretations. However, the board believes this paper will assist those parties interested in peer review to gain a better understanding of the revised guidance and serve as a helpful resource to navigating through the revised Standards and Interpretations.

## **Introduction**

Have you heard about the new peer review standards, which make peer review simpler?

The AICPA Peer Review Board (board) has issued revised *Standards for Performing and Reporting on Peer Reviews* and Interpretations to the Standards (hereinafter, collectively the revised Standards). This white paper has been structured so that you can decide easily how much time you want to invest in learning about the changes:

- [Section I](#), including exhibit A, discusses the top level changes in the reporting processes, considered to be the most significant of the changes.
- [Section II](#) (page 5), including exhibit B, provides you with summaries of the changes in chart form based on user type. The more significant changes are hyperlinked to exhibit C (immediately following section IV), which provides a more detailed discussion of those changes, including background and explanations, where applicable.
- [Section III](#) (page 14) discusses how your comment letters in response to the exposure draft were considered in the process of finalizing the revised Standards.
- [Section IV](#) (page 18) discusses how you can learn more about the revised Standards, including how you can reach out to the firms you peer review or administer regarding how the revised Standards affect them.

## **Section I – Reporting Model Changes**

One of the most significant changes is to the reporting model. The foundation of the model is a set of terms—*matter*, *finding*, *deficiency*, and *significant deficiency*—and their related definitions used to describe conditions that could be noted during a System Review or an Engagement Review. The revised Standards establish a hierarchy or ladder that a matter gets elevated through, if applicable, and provides guidance for aggregating and evaluating those conditions, documenting them, and determining how they might affect the type of report issued.

For System Reviews, determining the significance of individual matters, combined with others or alone, in conjunction with the nature, cause, pattern, pervasiveness, and relative importance to the system of quality control as a whole, is a matter of professional judgment, and careful consideration is required in forming such conclusions and determining the impact on a peer review report. For Engagement Reviews, determining the nature and significance of individual matters, combined with others or alone, is also an important process.

The definitions of the terms and how they flow through the process may seem complex; however, there are several tools to assist you in understanding them. The first is the model in [exhibit A](#) (page 4), which illustrates the ladder that the terms could follow, along with how the conditions are documented and possible ramifications to the peer review. Another tool is the reporting model flowcharts which have already been integrated into the revised Standards in exhibits A and B, which the board believes will be integral to a user’s understanding of the process.

“Findings” currently reflected in letters of comments (LOC) are often confusing and misunderstood when read with a “clean,” or unmodified peer report, when by their nature, the findings included in

the LOC are not of such significance to affect the opinion or type of report issued. Therefore, the board concluded to eliminate the LOC. However, in order to retain the spirit of the peer review program and its objective of promoting quality in the accounting, auditing, and attestation services provided by AICPA members and their CPA firms, the board wanted peer reviewers to retain the ability to continue to educate and inform firms as to their findings. To accomplish this, the board expanded the use of existing peer reviewer working paper documentation (outside of the reporting and acceptance process) to communicate findings to the reviewed firm that do not affect the peer review report issued. The new process introduces the Finding for Further Consideration (FFC) form as a new written mechanism, which allows peer reviewers to offer substantive comments and recommendations on the firm’s practices on such findings and for firms to provide meaningful responses to those findings, comments, and recommendations. The consideration of the need for an FFC form in the revised system review reporting model is similar to the consideration in determining whether a letter of comment is appropriate in the current System Review reporting model.

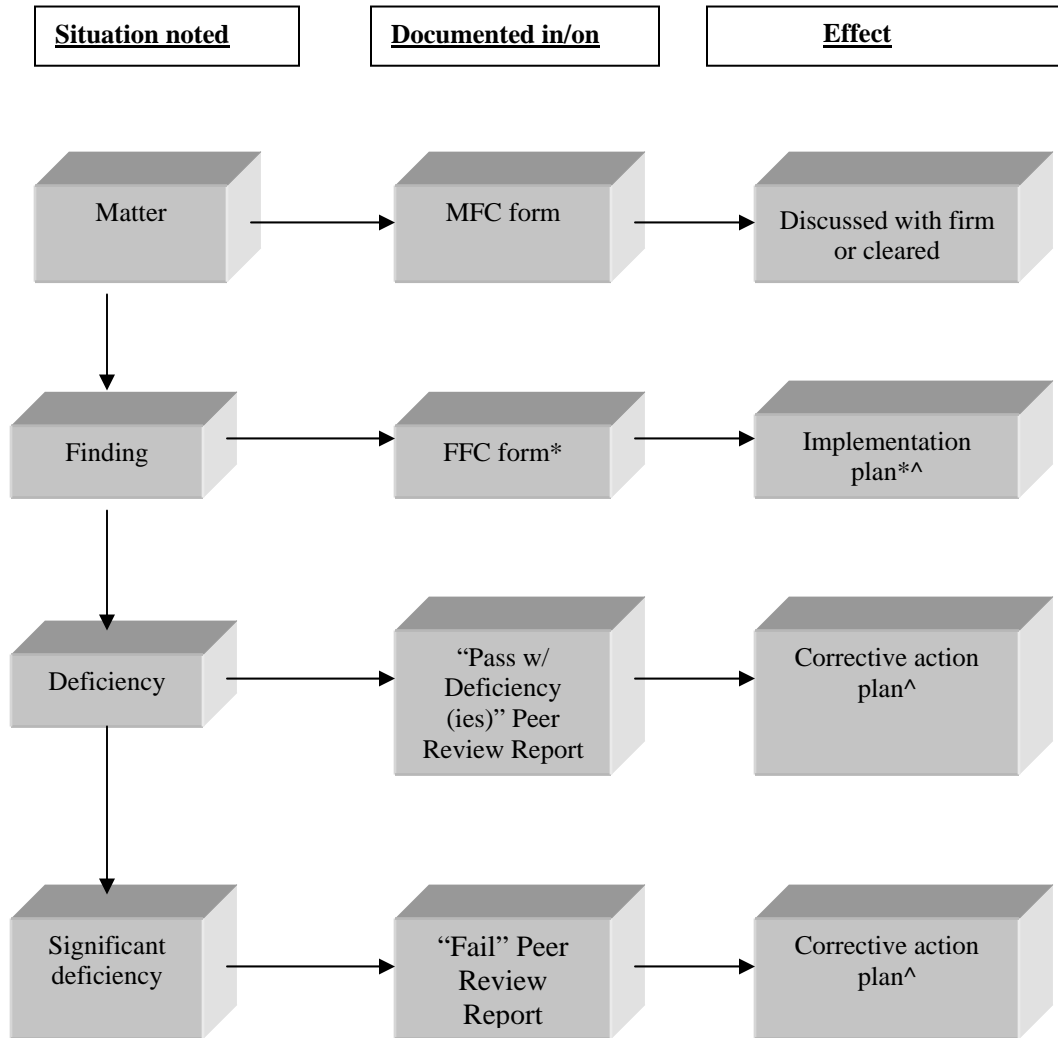
In conjunction with the preceding text, the peer review reports were revised to be more concise and understandable, and the report grades were changed to pass, pass with deficiency, and fail.

This new reporting model promotes consistency and efficiency. It also improves transparency—in reading the report, the quality of the firm’s practice becomes more transparent. The process to determine what type of report should be issued is much more robust and challenges reviewers to make those hard decisions and consider threshold questions in determining what type of report to issue. This is why the board expects to see more peer review reports issued with a grade of pass with deficiency than have been issued with a grade of modified under the current Standards. This is best illustrated by the following chart which compares the reporting model under the current versus revised Standards:

Current Standards	Revised Standards
<b>Unmodified – No LOC</b> (Matter – MFC) -or- <b>Unmodified – LOC</b> (Finding – in LOC)	<b>Pass</b> (Matter – MFC) (Finding – FFC)
<b>Modified – LOC</b> (Deficiency – in report) (Finding – in LOC)	<b>Pass with Deficiency</b> (Deficiency – in report)
<b>Adverse</b> (Deficiency – in report)	<b>Fail</b> (Significant deficiency – in report)

It is important for reviewed firms and the public, including governmental entities and regulators, to have access to understandable peer review results that clearly articulate the quality of the CPA firm’s practice. The board believes that the changes to the reporting model meet these objectives, and that the users of peer review reports will have the information they need to make informed decisions about reviewed firms in a more consistent and understandable format. [More information](#)

**Exhibit A:**



\* Only if the finding is not elevated to a deficiency or significant deficiency

^ Only if requested by the administering entity's peer review committee

To illustrate, in a System Review, a matter is documented on a Matter for Further Consideration (MFC) form and discussed with the firm or cleared. If it does not get elevated further, a report with a peer review rating of pass is issued. However, depending on the resolution of a matter, and the process of aggregating and evaluating peer review results, a matter may develop into a finding. Findings will also be evaluated and, after considering the nature, causes, pattern, pervasiveness, and relative importance to the system of quality control as a whole, may not get elevated to a deficiency or significant deficiency. Such finding is documented on an FFC form, and the administering entity's peer review committee will determine if it should require an implementation plan from the reviewed firm in addition to or as an affirmation of the plan described by the firm in its response to the

findings on the FFC form. However, if during that process, the matter, which has been elevated to a finding (and thus far only documented on the MFC form) is further elevated to a deficiency or significant deficiency, it is communicated in the report itself (pass with deficiency or fail report, respectively), along with the reviewer's recommendation. The administering entity's peer review committee will ordinarily require remedial, corrective actions related to the deficiencies or significant deficiencies noted in the peer review report, in addition to or as an affirmation of those described by the reviewed firm in its letter of response. Because it is possible for a firm to receive a pass with deficiency or fail report, as well as FFCs which had not been elevated to deficiency or significant deficiency, it is possible for the firm to be responsible for submitting a corrective action plan related to the deficiency(ies) or significant deficiencies in the peer review report, as well as an implementation plan in response to the FFCs that did not get elevated.

## **Section II – A User's Guide to Changes Reflected in the Revised Standards**

[Exhibit B](#) (page 6), which follows, covers the more significant changes in the revised Standards as compared to the current Standards, including what user(s) the change more directly affects. The changes, where applicable, have been cross-referenced to the applicable paragraph number(s) (P) in the revised Standards or the applicable Interpretation number(s) (Int.), or both. Certain, more significant changes are linked to more detailed discussions in [exhibit C](#) (page 19). This guide does not contain a comprehensive list of changes; although, it does include the more relevant changes. Accordingly, you are urged to carefully read the full revised Standards.

**Exhibit B:**

<b>The Revised Standards &amp; Interpretations:</b>	<b>Revised Standards/ Interpretation ref.</b>	<b>Enrolled firms</b>	<b>Peer reviewers</b>	<b>Administering entities*</b>	<b>National PRC**</b>	<b>Other interested parties</b>
<b><u>General:</u></b>						
Are more <a href="#">principles based</a> ; detailed guidance is in the Interpretations, which have been restructured and reformatted.	N/A	-	X	X	X	-
Incorporates Statement on Standards for Quality Control No. 7, <i>A Firm's System of Quality Control</i> throughout the guidance.	Various	X	X	-	X	-
Clarifies that the revised <a href="#">Standards can be used</a> by certain approved administering entities to administer peer reviews of non-AICPA firms and under what circumstances and clarifies current enrollment eligibility requirements.	P1/Int.1	-	-	X	-	-
<b><u>Introduction and scope:</u></b>						
Revises guidance on what is to be included in the reviewed firm's <a href="#">representation letter</a> and for reviewed firms currently enrolled in CPCAF PRP, requires a representation letter (not previously required)	P5f & P181 (App. B)	X	X	-	X	-
<a href="#">Enhances guidance on what constitutes noncooperation</a> with the program and what actions can be taken by the board.	P5h/Int.5 & P128, 130, 148-153	X	X	X	X	-
Adds audits of non-Securities and Exchange Commission (SEC) issuers performed pursuant to the standards of the Public Company Accounting Oversight Board (PCAOB) into the Standards definition of an accounting and auditing practice.	P6 & 7	X	-	-	X	-
<p>* <b>Change affects procedures of an administering entity's (AE's) peer review committee, report acceptance body, technical reviewers, and administrators. Changes affecting peer reviewers will indirectly also affect the AE.</b></p> <p>** <b>National Peer Review Committee (PRC) (formerly Center for Public Company Audit Firms [CPCAF] Peer Review Program [PRP]) includes firms to be administered by the National PRC, peer reviewers who perform their reviews, and the AICPA as administrator of the National PRC.</b></p>						



<b>The Revised Standards &amp; Interpretations:</b>	<b>Revised Standards/ Interpretation ref.</b>	<b>Enrolled firms</b>	<b>Peer reviewers</b>	<b>Administering entities*</b>	<b>National PRC**</b>	<b>Other interested parties</b>
Provides qualitative guidance for performing System Reviews at a location other than the reviewed firm’s office.	P8/Int. 7	X	X	X	X	-
<b><u>Administrative requirements:</u></b>						
“ <a href="#">Merges</a> ” the two peer review programs—the National Peer Review Committee (National PRC) will administer the Program at the AICPA for those peer reviews previously performed under the auspices of the CPCAF PRP.	P11&128/Int.8	-	-	-	X	X
Requires firms who are required to be registered with and inspected by the PCAOB, and firms who perform audits of non-SEC issuers pursuant to the standards of the PCAOB, to have their reviews administered by the National PRC.	P11&128/Int.8	X	-	X	X	-
Enhanced guidance regarding what is subject to oversight (peer reviews, including the reviewed firm and peer reviewers and administering entities) and by whom, and related guidance.	P12	X	X	X	X	X
<b><u>Timing of peer reviews:</u></b>						
Adds enhanced guidance on defining when a firm should have enrolled.	P13/Int.9	X	-	X	X	X
Adds enhanced guidance on “step up” System Reviews.	P14/Int.9	X	X	X	-	-
Adds enhanced guidance on how changes in peer review year ends correlate with changes in due dates, plus requests for due date extensions.	P18/Int.9	X	X	X	X	-
<b><u>Independence, integrity, and objectivity:</u></b>						
Creates an <a href="#">independence impairment</a> for internal inspectors, consulting reviewers, and preissuance reviewers intending to perform certain peer reviews.	P21/Int.10	X	X	X	X	X

<b>The Revised Standards &amp; Interpretations:</b>	<b>Revised Standards/ Interpretation ref.</b>	<b>Enrolled firms</b>	<b>Peer reviewers</b>	<b>Administering entities*</b>	<b>National PRC**</b>	<b>Other interested parties</b>
<b><u>Peer review documentation and retention policy:</u></b>						
Provides guidance for when substantial equivalents to materials and checklists issued by the board are appropriate, including requirement to obtain advance AE approval.	P24/Int.11	-	X	X	X	-
Requires that the peer reviewer and the administering entity retain FFC forms until the reviewed firm's next peer review.	P25/Int.11	-	X	X	X	-
Modifies the peer review documentation <a href="#">retention period</a> from 90 days to 120 days.	P25/Int.11	-	X	X	X	-
<b><u>Organizing the System or Engagement Review team:</u></b>						
Clarifies the role of associations of CPA firms in the peer review process.	P26/Int.12	-	-	-	X	X
Adds the concept of a review team assessing its “capability” to perform a peer review.	P27 & 28	-	X	-	-	-
Clarifies that the term <i>team captain</i> is for System Reviews and <i>review captain</i> is for Engagement Reviews (vs. terms <i>team captain</i> and <i>reviewer</i> ).	P29	-	X	X	-	-
<b><u>Qualifying for service as a peer reviewer:</u></b>						
Change in reviewing firm qualifications for reviewed firms currently enrolled in CPCAF PRP who voluntarily agree to have their review administered by the National PRC.	P31b/Int.14	-	-	-	X	-
Adds the requirement, currently addressed in other existing guidance, that peer reviewers timely complete and update a resume that accurately reflects their reviewer qualifications, including recent industry experience.	P31f/Int.14	-	X	X	X	-

<b>The Revised Standards &amp; Interpretations:</b>	<b>Revised Standards/ Interpretation ref.</b>	<b>Enrolled firms</b>	<b>Peer reviewers</b>	<b>Administering entities*</b>	<b>National PRC**</b>	<b>Other interested parties</b>
Adds the requirement that the team captain is required to ensure that all team members possess the necessary capabilities and competencies to perform assigned responsibilities and that team members are adequately supervised.	P32	-	X	X	-	-
Removes the requirement for reviewer <a href="#">completion of a training course</a> (s) when the function of the reviewer is other than reviewing engagements.	P33/Int.14	-	X	X	-	-
Changes course requirements for reviewers who currently perform CPCAF PRP reviews from requiring a course within 5 years to within 3 years.	P33/Int. 14	-	-	-	X	-
Changes team captain rotation requirements for reviewed firms currently enrolled in CPCAF PRP (to be required only for firms with >400 professionals).	P33/Int.14	-	-	-	X	-
Clarifies guidance about <a href="#">restrictions and limitations</a> on peer reviewer's practices, including peer reviewers informing administering entities of communications received relating to allegations or investigations in the conduct of accounting, auditing, or attestation engagements.	P34/Int.14	-	X	X	X	-
<b><u>Performing System &amp; Engagement Reviews:</u></b>						
Provides team captain guidance applicable to a reviewed firm that has undergone a <a href="#">PCAOB inspection</a> , including inquiries of appropriate firm personnel.	P40/Int.15 & P181(App. B)	-	-	-	X	-
Enhances guidance on understanding the reviewed firm's monitoring processes to reduce the scope of the peer review.	P45/Int.16	-	X	X	X	-

<b>The Revised Standards &amp; Interpretations:</b>	<b>Revised Standards/ Interpretation ref.</b>	<b>Enrolled firms</b>	<b>Peer reviewers</b>	<b>Administering entities*</b>	<b>National PRC**</b>	<b>Other interested parties</b>
Enhances the guidance on exclusion of engagements and functional areas from scope and the effect, if any, on the report issued (could be pass, pass with deficiency(ies), or fail) and related enhanced documentation requirements.	P55/Int. 17, P96 & P122	X	X	X	X	-
Changes timing of initial selection of engagements provided to the reviewed firm to no earlier than 3 weeks, and for reviewed firms currently enrolled in CPCAF PRP, requires at least one engagement to not be provided to the reviewed firm in advance (not previously required)	P61	X	X	-	X	-
Enhances guidance of coverage of must pick engagements in System Reviews.	P63/Int.18	-	X	-	-	-
Incorporates a more systems oriented approach for Systems Reviews; in doing so, substandard terminology is eliminated.	P66/Int. 19	-	X	X	X	-
<u>Defines the terms</u> <i>matter, finding, deficiency, and significant deficiency</i> , provides enhanced process guidance and describes how the affect on the type of report issued on a System or Engagement Review.	P69-90 & P110-119	-	X	X	X	-
<u>Expands the use of existing MFC form</u> , allowing a derivation of it, called the Finding for Further Consideration (FFC) form, to communicate findings to the reviewed firm and receive related written responses that don't affect the opinion or type of peer review report issued. This change eliminates the separate letter of comment.	P69-90 & P110-120	X	X	X	X	-

<b>The Revised Standards &amp; Interpretations:</b>	<b>Revised Standards/ Interpretation ref.</b>	<b>Enrolled firms</b>	<b>Peer reviewers</b>	<b>Administering entities*</b>	<b>National PRC**</b>	<b>Other interested parties</b>
Revamps the <a href="#">wording of peer review reports</a> to make them more concise and understandable and changes peer review report grades to pass, pass with deficiency, and fail (from unmodified, modified, and adverse).	P87-90, 95,96,117-121&122, P182-194 (App. C-Q)	<b>X</b>	<b>X</b>	<b>X</b>	<b>X</b>	<b>X</b>
<a href="#">Defines an implementation plan</a> as a possible action required as a response to an FFC(s) and provides guidance on how they differ from correction action plans.	P92,115,141-145	<b>X</b>	<b>X</b>	<b>X</b>	<b>X</b>	-
Revises the definition of what constitutes a repeat finding for System Reviews and Engagement Reviews.	P96n & P122	-	<b>X</b>	<b>X</b>	-	-
Requires disclosure of the industry and level of service in a deficiency or significant deficiency when it is industry specific.	P96o & P122	-	<b>X</b>	-	<b>X</b>	<b>X</b>
Eliminates the requirement for reviewed firms to submit a copy of their peer review report to its AE, unless the report's grade is pass with deficiency(ies) or fail.	P98 & P124	<b>X</b>		<b>X</b>	<b>X</b>	-
Provides guidance for the submission of FFC forms to AEs by the team captain or review captain.	P99 & 125/ Int. 21	<b>X</b>	<b>X</b>	-	<b>X</b>	-
<a href="#">Folds Report Reviews into Engagement Reviews in conjunction with changing the extent of procedures performed in Engagement Reviews</a> on compilation engagements performed under Statements on Standards for Accounting and Review Services.	P108d	<b>X</b>	<b>X</b>	<b>X</b>	<b>X</b>	-

<b>The Revised Standards &amp; Interpretations:</b>	<b>Revised Standards/ Interpretation ref.</b>	<b>Enrolled firms</b>	<b>Peer reviewers</b>	<b>Administering entities*</b>	<b>National PRC**</b>	<b>Other interested parties</b>
Provides an option to reviewed firms currently enrolled in CPCAF PRP to have an Engagement Review, when applicable.	P102-107	-	-	-	X	-
Provides guidance for the type of report to be issued in an Engagement Review when the exact same significant deficiency occurs on each of the engagements submitted for review, and there are no other significant deficiencies.	P118 & 119	-	X	X	X	-
Changes the Engagement Review report to state that its objective is to “evaluate” whether the engagements submitted for review were performed and reported in conformity with applicable professional standards in all material respects and include language regarding the firm’s responsibility for designing and complying with a system of quality control.	P122	-	X	-	X	X
<b><u>Administering peer reviews:</u></b>						
Provides for AEs and others to request flexibility, in advance and in specific circumstances, in implementing alternate methods of complying with the standards.	P131	X	X	X	X	-
<b><u>Fulfilling PRC and report acceptance body (RAB) responsibilities:</u></b>						
Enhances peer reviewer qualifications to include recent experience in and knowledge about current rules and regulations <i>appropriate to the level of service</i> applicable to the industries of the engagements that the individual will be reviewing.	P31d/Int.14	-	X	X	-	-

<b>The Revised Standards &amp; Interpretations:</b>	<b>Revised Standards/ Interpretation ref.</b>	<b>Enrolled firms</b>	<b>Peer reviewers</b>	<b>Administering entities*</b>	<b>National PRC**</b>	<b>Other interested parties</b>
Enhances technical reviewer qualifications to elaborate on requirement to participate in at least one peer review each year and clarifies that they should have an appropriate level of accounting and auditing knowledge and experience suitable for the work performed, in addition to existing CPE requirements.	P132/Int.22	-	-	X	X	-
Defines the objectives of a peer review committee (PRC) and its relationship to an RAB and enhanced discussion of the PRC's report acceptance body responsibilities.	P132 & 133	-	-	X	X	-
<b><u>Accepting System and Engagement Reviews:</u></b>						
Allows for certain Engagement Reviews to be accepted by an AE's technical reviewers.	P137/Int. 23	-	-	X	X	-
<b><u>Performing and Reporting on QCM/CPE Programs:</u></b>						
Incorporates guidance for performing and reporting on peer reviews of quality control materials and continuing professional education programs.	P154-178	-	X	X	X	-

### **Section III - How Your Responses to the Exposure Draft Were Considered**

An [exposure draft](#) on the revised Standards<sup>1</sup> was issued in April 2007. Sixty [comment letters](#)<sup>2</sup> were received, including nine from state boards of accountancy (SBOA). The letters included approximately 400 individual comments, each of which was carefully analyzed and evaluated by the board and its Standards Task Force. All SBOAs, as well as other regulators and interested parties, were invited to the board's August and October 2007 meetings where the comment letters and the board's responses to them were discussed. Although the board determined that no major change in direction from the exposed revised Standards would be necessary, many important additional revisions were made throughout the revised Standards in response to the comments received to help clarify and tighten up the revised Standards. The board and the AICPA continue to have productive discussions with various interested parties, including regulators, and have been addressing questions raised. It is also worthy to note that the National Association of State Boards of Accountancy (NASBA) has since adopted the new peer review report rating model of pass, pass with deficiencies, and fail in its most recent edition of the Uniform Accountancy Act (UAA) Rules.

A general observation from the comments received was the number of mixed responses which challenged some of the same concepts that the board and its Standards Task Force had been debating for some time. Some of the issues debated were difficult to address, some were admittedly sensitive, and many were a challenge. The board revisited these issues in light of the comments received and is confident that each issue received due and fair consideration.

Another general observation was that additional wrap around guidance would be necessary for a number of issues to help users understand and implement the revised Standards. This is discussed in more detail in [section IV](#) (page 18).

The more significant comments, how they were addressed, and links to more detailed discussions in [exhibit C](#) (page 19), when applicable, follow:

#### *New Report Grading System*

The board received comments related to the new report grading system. Some were in favor and others were not, but no workable alternative recommendations to the grades pass, pass with deficiency, and fail were provided. Ultimately, the new grades were considered the most appropriate because they most clearly reflect the peer review results they represent. [More information](#)

#### *URL in the Report*

Some comments expressed discomfort with the use of a URL in the peer review report. After discussion, the board reaffirmed that using a URL met the board's objectives of revising the report to be more concise and understandable. It accomplishes this by linking the reader to the nature, objectives, scope, limitations of, and the procedures performed in the review, as well as the full revised Standards, instead of most of this information being included in the peer review report itself (or an attachment to the report). However, the board understood the concern about the long and

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<sup>1</sup> Interpretations are discussed and developed in open meetings by the board and do not need to be exposed for public comment. However, they were included with the exposed Standards for review and comment because they are an integral part of understanding the peer review process and provide clarification of matters within the Standards.

<sup>2</sup> The comment letters are part of the public record of the AICPA Peer Review Program and are available for public inspection until September 30, 2008.



awkward URL address which had originally been proposed. Thus, the URL was shortened to [www.aicpa.org/prsummary](http://www.aicpa.org/prsummary). [More information](#)

#### *Elimination of the LOC*

There were several comments regarding the elimination of the LOC and challenging how this step could enhance transparency. The board referred back to the responses of a previous survey, which indicated that many firms and users disliked the LOC process and didn't see the necessity for some of the information being public in a report. The continued use of the LOC was viewed as an impediment to the move towards increased transparency of the program as a whole. Also, there is a disproportionate effort that goes into writing a LOC that doesn't affect the peer review report grade. The objective of the program is to assist firms in a positive and remedial manner; this objective is met by the new reporting process and the use of the new FFC form which allows peer reviewers to offer substantive comments and recommendations on the firm's practices and for firms to provide meaningful responses. The FFC form will be more candid and specific than the letters of comment. When the results go to the report acceptance body, it will have better information from the FFC form to determine whether the peer review report is appropriate in the circumstances. The board believes that provision of an LOC was not intended to be seen as a fourth type of report as they currently have become (a 'pass is a pass' report whether or not there is an LOC). Eliminating the LOC will enhance transparency by requiring reviewers to carefully evaluate the thresholds in determining the peer review report grade. [More information](#)

#### *Elimination of the Term Substandard*

The respondents also questioned the elimination of the term *substandard*. This change was prompted by the board's observation that the focus on substandards has been causing unintended consequences, that is, that the existence of (any number of) substandards led to particular peer review results. The board expects that reviewers will better contemplate the definitions of the terms *matter*, *finding*, *deficiency*, and *significant deficiency* and follow them through the process flow to determine the correct report type in a System Review. Engagements meeting certain criteria as described in the Interpretations will still be identified and tracked for standards development and related purposes. [More information](#)

#### *Distinction Between Deficiencies and Significant Deficiencies*

A number of comments stated that there wasn't a fine enough distinction between deficiencies and significant deficiencies. The board agreed and refined and clarified the definitions and is developing wrap around guidance to enhance the distinctions and better explain how deficiencies and significant deficiencies flow to the peer review reports. The guidance recognizes the need for a qualitative versus quantitative approach to assessing thresholds and emphasizes the increased focus on the system of quality control (for System Reviews). The board also received comments that the definitions used for *deficiency* and *significant deficiency* were notably different in concept from the definitions of those terms in other professional guidance. After discussion, including consideration as to how the definitions were used in the process and how they flowed into the reports, the board reaffirmed that the definitions were appropriate for purposes of the revised Standards.

#### *Report Reviews Folded Into Engagement Reviews*

Some respondents expressed concern about the increased cost to certain reviewed firms if Report Reviews were to be folded into Engagement Reviews. The board determined that peer review procedures for firms that only performed compilations would essentially be the same, and if the

firm's practice remained the same, there would be no significant change in the amount of time required to perform the review. It is further noted that the reviewed firm would only be required to submit a letter of response if the report type was pass with deficiency(ies) or fail. [More information](#)

### *Independence and Monitoring*

The exposure draft had proposed that a firm performing another firm's internal inspection could not perform their peer review unless the internal inspection was being performed by the firm as a follow up action requested by the board. The board believed that if a peer reviewer performed an inspection, which is an important facet of the monitoring element and then performed the same firm's next peer review, it would be tantamount to reviewing his or her own work, which results in a lack of independence. However, there were a number of comments submitted on this issue because reviewers provide valuable assistance to firms in intervening years. The board is aware that this is a concern of smaller firms and considered the limitations that the proposed change might impose on firms who would need to change either internal inspectors or peer reviewers to comply with this guidance. They also considered the length of time between inspections and the next peer review. As a result, the board modified the proposed guidance to allow for the team captain (review team member) to perform the firm's inspection in the year following the firm's peer review without it impairing independence and, hence, the ability to perform the next peer review; however, independence would be impaired if the team captain (review team member) performed the firm's inspection in year two following the peer review or the year of the firm's subsequent peer review. The board determined that this was an appropriate conclusion on a significant issue because the resultant change would still strengthen the program and its credibility but would still allow for some flexibility. [More information](#)

### *Peer Review Training Courses*

The board received comments on the change in the requirement for certain reviewers to take the peer review training course. Current Standards require that team members who perform procedures in addition to preparing and completing the engagement checklists and MFC forms, such as the performance of interviews or the review of functional areas, attend a peer review training course. This requirement was removed in the revised Standards. The board reaffirmed that it is more important that the team member have the required industry experience. Requiring a team member to have peer review training was not always effective and is a barrier to getting more AICPA members involved in performing peer reviews. However, the board did add to the revised Standards that the team captain is responsible for ensuring that their team's members have the necessary training and knowledge to perform their assigned tasks. [More information](#)

### *Team Captain/Review Captain*

There were comments received regarding the terminology of *team captain* for a System Review and the refined term of *review captain* for an Engagement Review. The board considered that the use of the term *reviewer* for Engagement Reviews led to confusion with the term loosely used to refer to someone reviewing engagements, whether on a System Review or Engagement Review. They also considered that the review captain may be the only person on the review, but he or she is still the lead individual, otherwise said, "a ship's captain is a captain whether or not he or she has a crew." The board debated using one or the other term for both types of peer reviews, but they determined that due to there being some different tasks required of each "captain" depending on the review type, that a different name for each review type was still needed.

### *Scope Limitations*

Some of the comments expressed concern with the area of scope limitations. In the current Standards, scope limitations are addressed in modified reports. In the revised Standards, a scope limitation doesn't necessarily result in a deficiency. In response, the board reevaluated all the guidance related to scope limitations and matters of noncooperation and made clear distinctions between the two. In addition, the revised Standards reflect that a firm could receive a peer review report with a report grade of pass with scope limitation, pass with deficiency (with a scope limitation), or fail (with scope limitation).

### *Other Changes*

Some other changes reflected in the revised Standards, prompted by your responses to the exposure draft, were the following:

- Elimination of the requirement for reviewed firms to submit a copy of their peer review report to its administering entity, unless the peer review report has a report grade of pass with deficiency(ies) or fail
- Clarification of the guidance regarding the disclosure of 'industry' in deficiencies and significant deficiencies included in peer review reports with a report grade of pass with deficiency(ies) or fail
- Modification of the guidance for performing System Reviews at a location other than the reviewed firm's office, by developing criteria that are more qualitative versus quantitative
- Clarification of guidance such that technical reviewers can be delegated the responsibility to accept Engagement Reviews unless there are MFCs on engagements for a review or a higher level of service, even when feedback is provided to the review captain warranting committee consideration and circumstances leading up to the feedback may have affected the results of the review
- Change to timing of initial selection of engagements provided to the reviewed firm to no earlier than 3 weeks (vs. 2 weeks)
- Clarification of certain report illustrations to coincide more clearly with other guidance in the revised Standards

### *Other*

In response to comments received, the board acknowledges that there will be a learning curve with the revised Standards. However, there is a good link between the old and the new guidance, which will facilitate the transition from one to the other, and the learning curve will be offset, to some extent, by the efficiencies gained, for instance, by the elimination of the letter of comment.

The board also acknowledges the frequency in changing the peer review Standards. This has been necessary as part of the program's continued process of self-improvement, including the need to be responsive to peer review users' needs. In fact, the issuance of the Standards was the culmination of several years of research, discussion, surveys, drafting, and rewrites. The revisions recognize the importance of peer review in the SBOA licensure process. Currently, 43 state boards require peer review, as do other regulators such as the Government Accountability Office. The board strongly believes that the revisions will improve peer review execution and rigor. Also, a new reporting model designed to meet the needs of reviewed firms and other stakeholders enhances the peer review report's clarity, comparability, and understandability.

The frequency of updates to the Standards will decrease once these principles based, revised Standards are implemented and after the learning curve has stabilized. The revised Standards have flexibility built in to allow for changes without exposure. In addition, the revised Standards establish one peer review program under one set of standards for all enrolled firms, and this, coupled with the other revised Standards enhancements, is expected to result in a more efficient and effective program.

#### **Section IV - How to Learn More**

The principles based revised Standards, and the Interpretations which elaborate on them, form the foundation of the program's guidance. They will be supplemented by vital wrap around guidance, which is in development. Some guidance will be issued initially in the form of Reviewer's Alerts so that they can be released to users on a timely basis as they are approved by the board. At the appropriate time, that guidance will be reevaluated to determine if it is more appropriate to take the form of revised interpretations or other sections of the Peer Review Program Reference Manual. The best resource for keeping abreast of wrap around guidance as it is issued is the AICPA's peer review Web site at [www.aicpa.org/members/div/practmon/index.htm](http://www.aicpa.org/members/div/practmon/index.htm).

The board is also updating existing guidance developed specifically for administrative, peer review committee, report acceptance body, or oversight purposes. The best resource for administering entities to keep abreast of this wrap around guidance is the AICPA Communications Team's News Updates for state societies and contact with the Administrative Advisory Task Force.

The AICPA will develop a 2-4 hour Webcast on the changes in the revised Standards, which will be available in late 2008. In addition, we encourage you to monitor communications from your state societies or the AICPA directly for important updates. Peer review updates within conferences and seminars, for example, sponsored by state societies and other sponsors are also a valuable resource, as are discussions with your peers and other contacts.

The 2008 AICPA Peer Review Program Conference will be held November 12-14, 2008 in Las Vegas, Nevada. This conference will include the latest developments, insights, and training regarding the revised Standards, including the revised peer review process that peer reviewers, technical reviewers, administrators, report acceptance body, and committee members will encounter.

The development of the revised Standards was greatly enhanced by your input. In that continued spirit, please send your suggestions related to the revised Standards, its wrap around guidance, or any other related materials to [prptechnical@aicpa.org](mailto:prptechnical@aicpa.org) or call 919-402-4502 and ask to speak with a technical manager. Thank you for your interest in peer review.

Further Explanations of the Revisions and  
Other Matters Considered by the AICPA Board

1. Principles Based Standards and Related Reevaluation of All Guidance

*Principles Based Standards*

While AICPA firms are of diverse sizes and have diverse practices and peer review issues, their commonality is that they provide the same services using the same professional standards, and their peer reviews are intended to achieve the same basic objectives. With this in mind, the revised Standards have been structured to be more principles based, in order that they address the basic objectives of a peer review and how it is performed, reported upon, and administered, and so that they can be applicable to a diverse population of users. The revised Standards provide an overarching framework for the program; detailed guidance has been built into the Interpretations. This will allow the board to be more responsive to user feedback and environmental changes in that interpretive guidance can be modified as needed.

In conjunction with these changes, the Interpretations have been reformatted to link to specific paragraphs of the revised Standards (See Interpretations “Notice to Readers”).

Incorporated into the revised Standards is the recognition that administering entities, and in some situations, firms and peer reviewers, may need the flexibility, in specific circumstances, to implement alternate methods of complying with the revised Standards, Interpretations, or guidance issued by the board, and the revised Standards provide a mechanism and process for flexibility.

The intent is not for each administering entity to create its own set of standards, guidance, and materials, but rather to have a formal mechanism to make requests of the board for flexibility with unusual and infrequent situations. The request is to be submitted by the administering entity’s peer review committee in conjunction with the submission of its plan of administration. It is not expected that such requests would be made frequently or every time there is a difficult peer review. The comprehensiveness of the administering entity’s oversight policies and procedures as well as the results of its board oversight will be considered in the board’s determination.

*Reevaluation of All Guidance*

In conjunction with the restructuring of the Standards, all guidance therein was reevaluated, updated, and clarified. This was in response to input received over the past couple of years by the board from reviewed firms, peer reviewers, technical reviewers, and peer review committee members suggesting various changes to the organization (order) of the Standards as well as

revisions to various explanatory and narrative paragraphs and illustrations. Several of the revisions serve simply to update and clarify existing language. For example, performing and reporting on System Reviews is followed by performing and reporting on Engagements Reviews, rather than a discussion of “performance” on each followed by “reporting” on each. Other revisions were the result of discussion and debate on each aspect of the Standards and guidance that was viewed with a “fresh” approach in order to seize the opportunity to determine what would be responsive to its users’ feedback. As part of this process, the Securities and Exchange Commission (SEC) Practice Section (SECPS) peer review standards, mostly still in use by the CPCAF PRP, were also considered. Overall, the board believes that the revised Standards are clearer, more concise, and appropriate. [Back to exhibit B](#)

## 2. Use of the Revised Standards by Certain Approved Administering Entities and Current Enrollment Eligibility Requirements

This information is not a change to the Standards but it helps to clarify that board approved administering entities may use the revised Standards, as applicable, in administering peer reviews of non-AICPA firms. Administering entities should not imply that these firms are enrolled in the AICPA PRP. The board will issue additional guidance in this area to assist approved administering entities, who also administer peer reviews for non-AICPA firms. In addition, the Interpretations discuss that firms in which at least one partner is a member of the AICPA, and in certain circumstances, individual AICPA members, may enroll in the program. [Back to exhibit B](#)

## 3. Reviewed Firm Representation Letters

The board reaffirmed the value and purpose of the representation letter for the peer review. The team captain and review captain obtains representations from management of the reviewed firm to describe matters significant to the peer review in order to assist in the planning and performance of and the reporting on the peer review. Existing guidance prescribes the elements to be included in representation letters. The revised guidance notes that specific representations should relate to the same elements, although it clarifies that the firm is not prohibited from making additional representations, and the firm may tailor the representation letter as it deems appropriate, as long as the minimum applicable representations are made. Other representations obtained by the team captain and review captain will depend on the circumstances and nature of the peer review. The revised guidance also provides an illustration of a representation letter that has been tailored to report to the team captain and review captain a matter of noncompliance with a regulatory requirement and notes that the firm may tailor that language and may refer to attachments to the letter as long as adequate representations pertaining to the matters discussed previously, as applicable, are included to the satisfaction of the team captain and review captain. [Back to exhibit B](#)

## 4. Enhances Guidance On What Constitutes Noncooperation With the Program and What Actions Can Be Taken by the Board

One of the cornerstones of the program is the responsibility of all involved to cooperate with the program. This is not a new concept, but it has been expanded upon in the revised Standards.

For instance, enrolled firms are responsible for cooperating with their peer reviewer, administering entity, and the board in all matters related to the peer review. Guidance related to what constitutes noncooperation has been enhanced to include, but not be limited to, situations where the reviewed firm is not responding to inquiries; withholding information significant to the peer review; limiting access to offices, personnel, or others; or failing to cooperate during oversight. Another example, enhanced for the revised Standards, is when a reviewed firm refuses to cooperate when a corrective action or implementation plan is requested by the administering entity's peer review committee, or when it fails to correct its deficiencies or significant deficiencies, or is found to be so seriously deficient in its performance that education and remedial, corrective actions or implementation plans are not adequate. In these situations, the board may decide, pursuant to due process procedures, to appoint a hearing panel to consider whether the firm's enrollment in the program should be terminated or whether some other action should be taken.

In the same spirit, administering entities and peer reviewers also have the responsibility to cooperate, and their noncooperation can result in the revocation of the administering entity's plan by the board or prohibition from performing peer reviews in the future, respectively. This is not a change from the current Standards.

Noncooperation guidance is crucial to ensure that the program is working efficiently and effectively and to help the program meet its goal of promoting quality in the accounting and auditing services provided by the CPA firms (and individuals) subject to the Standards. [Back to exhibit B](#)

5. “Merger” of the Two Peer Review Programs—One AICPA Peer Review Program for all AICPA Members Subject to Peer Review With the National PRC Administering the Program at the AICPA for Certain Firms

*Merger Efforts*

Since 2003, the board and the CPCAF PRC have discussed various harmonization and merger issues. A merger of the AICPA's two peer review programs is a natural progression of the changes that occurred in 2004 with the establishment of the Public Company Accounting Oversight Board (PCAOB) and the moving of the responsibility of regulating and inspecting firms' SEC practices over to the PCAOB. The most significant peer review related change made when transitioning the SECPS PRP to the CPCAF PRP was that the peer review process no longer included peer reviewing a firm's SEC issuer practices.

There were notable commonalities between the two programs; they both focus on the non-SEC issuer practice, have the same objectives, and their enrolled firms provide the same services using the same professional standards. Thus, it was concluded that a single program with a single set of peer review standards and a national administration and acceptance body for certain firms was appropriate. This structure delivers simplification to the AICPA's practice monitoring program, allows it to communicate to its users with “one voice,” and creates efficiencies in many aspects of its performance, reporting, and administration, which in turn enhances peer review.

### *Reconstituted Governance*

In moving towards the merger, and with the understanding that the board's Standards Task Force would be finalizing the exposure draft of proposed revisions to the Standards to apply to all AICPA members subject to peer review, the board was reconstituted in 2007 to include representation from a cross-section of the entire population of AICPA firms subject to peer review, including small, medium, regional, and the largest national firms. The board continues to include other members such as state CPA society chief executive officers and a regulator.

### *New Administering Entity*

Until the effective date of the revised Standards, the CPCAF PRP and PRC are separate and distinct from the AICPA PRP and board. Upon the effective date of these Standards, the CPCAF PRP and PRC will be discontinued, and the CPCAF PRC becomes the board's National PRC, which will administer the program at the AICPA for certain firms.

Under the revised Standards, firms that are required to be registered with and inspected by the PCAOB and those performing audits of non-SEC issuers pursuant to the standards of the PCAOB are required to have their AICPA PRP peer review administered by the National PRC (vs. the existing administering entity of the state where their head office is located).

Several factors led to this conclusion. For instance, although the peer review process excludes reviewing a firm's SEC issuer practice, peer review teams and peer review committees must still take into consideration the effect of the firm's PCAOB inspection process. Furthermore, peer reviewers and peer review committees must be knowledgeable about the standards issued by the PCAOB when peer reviewing and considering audits of non-SEC issuers performed pursuant to those standards. However, there is a current limited availability of technical reviewers and peer review committee members with this experience and background at the AICPA PRP's existing administering entities. The CPCAF PRC discussed these matters with the board, drawing on first hand experience of administering the peer reviews of such firms, and supports the proposal that a national peer review committee (to be the National PRC) be involved in administering and considering such peer reviews. It is expected that this approach will also optimize the consistency of addressing the issues associated with these peer reviews.

Firms currently enrolled in CPCAF PRP, and CPCAF PRP peer reviewers, will receive detailed communications in mid-2008 regarding transition issues which may affect them, including the merger's effect on their public file and CPCAF PRP oversight procedures and the adoption of AICPA PRP administrative policies and procedures. [Back to exhibit B](#)

## 6. Independence Impairment for Internal Inspectors, Consulting Reviewers, and Preissuance Reviewers Intending to Perform Peer Reviews

Under Interpretation No. 10 "Independence, Integrity, and Objectivity" of the revised Standards, independence would be considered impaired for purposes of being able to perform a firm's peer review (whether as a team captain or team member) for anyone also performing an internal inspection, consulting review, quality control document review, preliminary quality control procedures review, or preissuance review for the firm prior to the peer review. The only exception is if those services were performed for the year immediately following the previous peer review year end. Therefore, performing those services in the second year after the peer review or during the year of the next peer review would impair independence for peer review



purposes. This change was prompted by the board's concern that an individual and his or her firm becomes part of a firm's monitoring process and, hence, system of quality control when performing those services. The individual and his or her firm then risk losing their independence, integrity, and objectivity in having to evaluate that same monitoring process (in essence, their own work) and how it impacted the system of quality control or the engagements performed and reported upon by the firm.

It is very important for peer reviewers to focus on this change immediately because although the interpretation becomes effective for reviews commencing on or after January 1, 2009, the impact is immediate if peer reviewers have already performed or were planning to perform these services in 2008, and they want to remain eligible to perform the firm's peer review in 2009 (or later).

Understandably, a peer reviewer can be a valuable source of information to the reviewed firm outside of the peer review process. The Interpretations discuss other relationships and situations that would impair independence and those that wouldn't. However, professional judgment must be used in many cases when, during the period between peer reviews, the reviewed firm "consults" with the firm it intends to use as its reviewer. Consulting with the reviewing firm in and of itself does not impair that firm's ability to perform a subsequent peer review. However, when the frequency and extent of that consultation becomes an integral part of the reviewed firm's system of quality control (on any type of peer review), independence would then be considered impaired. Additional guidance on this issue is available at [Reviewer's Alert 08-01](#). [Back to exhibit B](#)

7. Documentation retention period from 90 days to 120 days

The board revised the documentation retention period from 90 days to 120 days in order to align with Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) requirements. [Back to exhibit B](#)

8. Requirement for Completion of a Peer Review Course When Function of the Reviewer Is Other Than Reviewing Engagements

The board noted that team members sometimes perform procedures in addition to preparing and completing the engagement checklists and MFC forms, such as the performance of interviews or the review of functional areas. This is considered a valuable training ground for new peer reviewers, team captains, and review captains. These reviewers work under the supervision of a qualified team captain or review captain, and their work is reviewed to the extent necessary under the circumstances, as required by the Standards. Administering entities perform oversight over peer reviews and reviewers. As such, the requirement for completion of a training course or courses by reviewers when the function of the reviewer is other than reviewing engagements has been eliminated. [Back to exhibit B](#)

9. Restrictions and Limitations of Practices and Communications Related to Allegations or Investigations in the Conduct of Accounting, Auditing, and Attest Engagements

After considerable discussion, the board enhanced the guidance related to restrictions and limitations of practices and communications related to allegations or investigations. It recognizes that these situations may impact the reviewer or reviewing firm's ability to perform the peer review. However, if the limitation or restriction has been placed on the firm or one or more of its offices, current guidance does not allow any of the individuals associated with the firm, or the portion thereof, to serve as reviewers. The board acknowledges that this may be too restrictive and, as such, in the revised Standards requires that the administering entity must carefully consider the specific circumstances, so as to evaluate whether any of the individuals associated with the firm, or the portion thereof, may serve as reviewers.

In addition, the board clarified guidance related to communications relating to allegations or investigations in the conduct of accounting, auditing, or attestation engagements in the revised Standards such that it is applicable to those from regulatory, monitoring, and enforcement bodies. The general reference to "litigation" has been removed due to the extent of potentially frivolous litigation. However, any litigation that may be relevant to the peer review should be discussed with the team captain or review captain. The board also clarified that the administering entity should be informed of communications relating to allegations or investigations, but that the fact that a reviewer has received such communication(s) does not automatically mean that he or she is ineligible to perform peer reviews. The administering entity will consider the matter, including whether any action, including performing oversight on the reviewer, is appropriate. [Back to exhibit B](#)

10. Guidance Applicable to Firms with SEC Issuers (Exclusion of SEC Issuer Practice and Team Captain's Responsibilities Regarding PCAOB Inspections)

In conjunction with expanding the program to include the enrollment of firms currently enrolled in the CPCAF PRP, the Standards were expanded to address issues that are unique to those firms. For instance, the Standards note that they are not intended for and exclude the review of the firm's accounting and auditing practice and system of quality control applicable to SEC issuers. However, where a firm has the same system of quality control for its SEC issuer and non-SEC issuer practices, the system of quality control is still evaluated.

The revised Standards also note that the team captain should discuss, with appropriate reviewed firm personnel, the reports submitted to the firm by the PCAOB or, in the absence of such a report, any findings that may have been communicated orally by the PCAOB to the firm. The team captain should consider what effects, if any, these matters could have on the firm's non-SEC issuer practice and the impact on peer review planning and other procedures. [Back to exhibit B](#)

11. Defined Terms for Matter, Finding, Deficiency, and Significant Deficiency and Related Enhanced Process Guidance

Significant feedback was expressed in a previous survey considered by the board regarding the understandability and usability of peer review reports, including how they are "rated" and letters of comments (collectively referred to as the *reporting process*). In addition, many comments noted the lack of consistency among (and amount of time spent by) peer reviewers and peer

review committees in writing and considering letters of comments, respectively, when by their nature, the matters included in letters of comments are not of such significance to affect the opinion or type of report issued.

In developing the revised Standards, it was noticeable that all of its users would need to first “speak the same language” to describe the conditions or issues they encounter during a peer review. Therefore, a set of definitions were developed to describe a *matter*, *finding*, *deficiency*, and *significant deficiency*. It is expected that the definitions will promote consistency, provide more structure and guidance for reviewers, and assist administering entities to effectively exercise their oversight responsibilities.

The definitions are the foundation to the new reporting model. The revised Standards establish a hierarchy or ladder that a matter gets elevated through, if applicable, and provides guidance for aggregating and evaluating those matters, documenting them, and determining how they might affect the type of report issued. For System Reviews, determining the significance of individual matters, combined with others or alone, in conjunction with the nature, cause (if applicable), pattern, pervasiveness, including the relative importance to the system of quality control as a whole is a matter of professional judgment, and careful consideration is required in forming such conclusions and the impact on a peer review report. For Engagement Reviews, determining the nature and significance of individual matters, combined with others or alone, is also an important process. These processes are summarized in flowcharts, one for System Reviews and another for Engagement Reviews, which the board believes will be integral to a user’s understanding of the process. The board expects to issue additional implementation guidance on these definitions.

In conjunction with these changes, System Reviews are to be more system oriented and, thus, references to substandard engagements, which is an engagement oriented concept, has been eliminated. Instead, the revised Standards assist the reviewer in determining the effect of matters noted on the firm’s system of quality control as a whole. Nevertheless, reviewers will be asked to continue to track those engagements which were not performed or reported in conformity with applicable professional standards in all material respects, so that administering entities and the program can continue to track statistics for analytical purposes. [Back to exhibit B](#)

12. Expands the Use of Existing Peer Reviewer Working Paper Documentation Outside of the Reporting and Acceptance Process to Communicate Findings to the Reviewed Firm That Don’t Affect the Peer Review Report Issued (Note: this is an expanded version of the update provided in section I of the white paper)

#### *Expands Current Documentation*

The board received significant feedback from users reflecting that they often found the current letter of comment to be confusing and misunderstood its purpose, in particular, in light of the letter of comment having no effect on the opinion or type of report issued. In addition, there is a large volume of resources committed by those involved in the peer review in refining the separate letter of comment and determining how comments are worded and presented. Considering these items, the board concluded to eliminate the separate letter of comment.

However, in order to retain the spirit of the peer review program and its objective of promoting quality in the accounting, auditing, and attestation services provided by the AICPA’s members

and their CPA firms, the board wanted peer reviewers to retain the ability to continue to educate and inform firms as to their findings and corrective actions. To accomplish this, the board expanded the use of existing peer reviewer working paper documentation (outside of the reporting and acceptance process) to communicate matters to the reviewed firm that don't affect the peer review report issued. This written mechanism allows peer reviewers to offer substantive comments and recommendations on the firm's practices on such matters and for firms to provide meaningful responses to those matters, comments, and recommendations.

It also provides transparency—the report provides a more transparent way to determine the quality of a firm's practice. It promotes consistency and efficiency and will force a reviewer to consider threshold questions in determining what type of report to issue.

The new process involves the use of the following forms:

*a.* MFC form

1. This form will be used similarly because it is under the current Standards.

*b.* Disposition of MFC (DMFC) form

1. The purpose of this new form is to ensure that all MFCs have been addressed and to document how they have been resolved. This form does not require further descriptions or explanations of the MFCs.
2. The form is a simple matrix whereby the reviewer lists the number assigned to each MFC and notes whether it was included in the report (and if so which item #), OR included in a FFC (see *c.*, which follows), (and if so, which one), OR another disposition of the MFC has occurred.
3. The DMFC is a section of the Summary Review Memorandum in a System Review and the Review Captain's Checklist in an Engagement Review and, thus, is part of the peer reviewer's working papers.

*c.* FFC form

1. The FFC is prepared in connection with a System Review if there are findings that the team captain believes resulted in conditions where there was more than a remote possibility that the firm would not perform and/or report on engagements in conformity with applicable professional standards, but were not of such significance to include in a report with a peer review rating of pass with deficiencies or fail. This is very similar to the consideration in determining whether a letter of comment is appropriate in the current system review reporting model.
2. The FFC is prepared in connection with an Engagement Review if there are findings that the review captain believes resulted in financial statements or information, related accountant's reports submitted for review, or the procedures performed not being performed in conformity with applicable professional standards that are not deemed to be significant deficiencies and were not of such significance to include in a report with a peer review rating of pass with deficiencies or fail. This is also very similar when

determining whether a letter of comment is appropriate in the current Engagement Review reporting model.

3. The FFC form

- i. provides a description of the finding, including whether it is a repeat, and the team captain's and review captain's recommendation on the finding(s).
- ii. identifies which MFCs are covered in the finding (because more than one MFC may generate a single finding due to a similar underlying cause in a System Review or similar situations on an engagement in an Engagement Review).
- iii. includes the reviewed firm's response, which must describe the actions planned or taken.
- iv. is signed by an authorized representative of the firm (not necessarily just the engagement partner).

4. The peer reviewer may use his or her professional judgment in writing the descriptions of matters and recommendations contained in this form. As long as it is completed in its entirety, includes the essential elements, is written in an understandable manner, and contains an appropriate response from the firm, it is expected that the administering entity would not request the form to be revised.

Guidance for the use of these forms is also illustrated by flowcharts in the revised Standards.

The MFC, DMFC, and FFC forms are reviewed by the administering entity's technical reviewer and submitted to the peer review committee. They determine whether the forms are prepared in accordance with the revised Standards, including whether the findings addressed on the FFC forms should have been included in a report with a peer review rating of pass with deficiencies or fail. They will also determine the adequacy of the plan the reviewed firm has represented, that it has implemented, or will implement in its response on the FFC form(s). Last, they will determine whether an implementation plan should be required in addition to or as an affirmation of the plan described by the reviewed firm in its response to the findings on the FFC form(s).

The MFC, DMFC, and FFC forms are a part of the peer reviewer's working papers and are not made publicly available, just as other peer reviewer working papers are not made publicly available. However, they are subject to oversight. In addition, FFC forms are retained by the administering entity (and should also be retained by the peer reviewer) in the administrative files until the completion of the next review and will be considered in the performance of that review.

*Findings Formerly Included in the LOC*

The board recognizes that the types of findings currently included in an LOC (that don't affect the opinion or type of report issued) are still very important to communicate to a firm, so it may use the information to improve the quality of its accounting and auditing practice. The board

believes the new procedures described previously enhance the existing process of communicating such findings to a reviewed firm.

It is important for the reviewed firms and the public, including governmental entities and regulators, to have access to understandable peer review results that clearly articulate the quality of the CPA firm's practice. The board believes that the revised Standards meet these objectives, and that the users of the peer review report will have the information they need to make informed decisions about reviewed firms in a more consistent and understandable format.

The board discussed whether some may interpret the revised reporting model as being less transparent because the findings formerly in the letters of comments will no longer be a part of the reporting process. The board concluded that the process is actually enhanced because reviewed firms and users of the peer review report will be able to focus on the deficiencies and significant deficiencies identified and that affected the report. At the same time, the reviewed firm will be able to focus on findings in the FFC forms. [Back to exhibit B](#)

### 13. More Understandable and Easier to Use Peer Review Reporting Model

The board received input from many sources, including reviewed firms, peer reviewers, technical reviewers, peer review committee members, and other users of peer review information, as well as the AICPA Board of Directors Peer Review Task Force, that the reporting model needed to be significantly revised. The board also recognizes that regulators that use the results of peer review expect certain types of information to remain in the peer review report. As a result of this feedback, the board reengineered the reporting model with a report that is more understandable and, thus, easier to use.

The new report

- a. identifies the type of peer review report (System Review Report or Engagement Review report) at the top of the report.
- b. shortens the report.
- c. contains language that is easier to understand.
- d. requires very little tailoring.
- e. makes reference to a URL for a "plain English" description of the nature, objectives, scope, limitations of, and procedures performed on the peer review (rather than this information being detailed in the report or an attachment).
- f. revises the "grading" of peer review reports from unmodified, modified, and adverse to peer review ratings of pass, pass with deficiency(ies), and fail, respectively. The peer review rating is clearly indicated in the opinion paragraph in a System Review and in the second paragraph in an Engagement Review. The revised Standards discuss forming conclusions on the different types of reports to issue on System and Engagement Reviews. The board recognizes that some of the existing peer review terminology is included in various regulatory and governmental body statutes, rules, and standards, and that revising the terminology in the Standards may mean regulators and other governmental bodies would

need to reevaluate such matters. This is one reason why the board's revisions to the grading of reports, including for unmodified reports, but particularly for modified and adverse reports, is really more of a name change that can be bridged to the terminology of *pass*, *pass with deficiency(ies)*, and *fail*, respectively.

- g. enhances the existing peer review report format whereby the report is a stand-alone document that discloses the deficiencies or significant deficiencies that form the basis for the type of report issued.
- h. includes no comments, deficiencies, significant deficiencies, or recommendations when the report has a peer review rating of pass.
- i. when the report has a peer review rating of pass with deficiencies or a peer review rating of fail:
  - the report includes written descriptions of deficiencies (pass with deficiencies report) or significant deficiencies (fail report) and a recommendation(s) for the reviewed firm to consider as a method of correcting the deficiencies or significant deficiencies. These descriptions are written similarly to how they are written in a modified or adverse System or Engagement Review report under the current Standards.
  - the written descriptions include the captions “deficiencies” and “recommendations.”
  - for a System Review, the descriptions of the deficiencies or significant deficiencies are systemically written, and the recommendation leans toward correcting the cause of the deficiencies or significant deficiencies.
  - on both System and Engagement Reviews, reviewed firms are required to submit appropriate responses addressing the deficiencies or significant deficiencies contained in the report.
  - the industry and level of service are to be identified in the report when a deficiency or significant deficiency is industry specific. Said another way, a nonindustry specific finding noted within an industry that is determined to apply system wide would not require the industry and level of service to be identified in the report. To promote consistency, this same approach is also applied to Engagement Reviews.
  - identification in the report of “substandard” engagements, along with this information specific to those engagements, has been deemed unnecessary. For system reviews, this is due to an increased systems focus.
- j. eliminates the reference from the peer review report to any other documents except for the reference to the revised Standards. [Back to exhibit B](#)

#### 14. Defines an Implementation Plan

Under the current Standards, a reviewed firm may be required to perform certain corrective actions to demonstrate that they have appropriately addressed the deficiencies or comments, or both, noted during a peer review and reflected in the modified or adverse report or letter of comments, or both. This process remains unchanged under the revised Standards as it relates to

deficiencies or significant deficiencies included in a report with a grade of pass with deficiency or fail. However, as a result of the elimination of the letter of comment and the related changes in the reporting model, the board needed a new process to address findings in the FFC form(s). That new process introduces the “implementation plan.”

Under the revised Standards, the committee will consider the nature and significance (and for system reviews, the causes, pattern, pervasiveness, and relative importance to the system of quality control as a whole) of the findings in the FFC form. It will evaluate whether the recommendations of the review team appear to address those findings adequately and whether the reviewed firm’s responses to those recommendations appear comprehensive, genuine, and feasible. If, as a result of these procedures, the peer review committee determines that an implementation plan related to the findings in the FFC form, in addition to or as an affirmation of the plan the reviewed firm has implemented or will implement (including timing) as described by the reviewed firm in its responses on the FFC form(s), is appropriate, the firm will be required to evidence its agreement to perform the implementation plan in writing and complete the action(s) as a condition of cooperation with the administering entity and the board.

Agreeing to and completing such a plan is *not* tied to the acceptance of the peer review. That is, the reviewed firm would nevertheless receive a “clean” acceptance letter for its peer review if the peer review committee did not otherwise request the firm to also perform a corrective action plan related to the deficiencies or significant deficiencies, if any, noted in the peer review report. However, if the firm fails to cooperate with the implementation plan, the firm would be subject to due process procedures that could result in the firm’s enrollment in the program being terminated.

To further illustrate, it is possible for a firm to receive a peer review report with a grade of pass with deficiency (for which the peer review committee requests a corrective action plan), and FFC forms on findings of a different nature than those which rose to the level of deficiency (for which the peer review committee requests an implementation plan). It is possible for the firm to first satisfy the corrective actions requested, receive its acceptance letter, and then satisfy its implementation plan, after which it will receive a letter acknowledging cooperation with the program in relation to the implementation plan. [Back to exhibit B](#)

#### 15. Report Reviews Folded into Engagement Reviews in Conjunction With Other Engagement Review Modifications

After considering six years of Report Reviews and the current goal of trying to make the peer review reporting process as consistent as possible, the board determined that it would be beneficial to fold Report Reviews into the Engagement Review process.

Because Report Reviews currently require comments and recommendations to be agreed upon prior to the issuance of the written report, the board believes that requiring a separate letter of response when there is a report with a rating of pass with deficiencies or fail, rather than the firm just signing the bottom of the report, would not be a significant revision or create a significant additional cost to the process, in particular, considering the elimination of the separate letter of comment and new procedures discussed previously regarding communication of findings that do not affect the report.



After concluding that the reports on engagement and report reviews would now be almost identical, the main differences remaining between the two types of peer reviews relate to the evaluation of documentation and the technical review and committee acceptance process.

#### *Evaluation of Documentation*

Engagement reviews include reading the financial statements or information submitted by the reviewed firm and the accountant's report thereon, together with certain background information and representations and the applicable documentation required by professional standards. However, under the revised Standards, for compilation engagements performed under the Statements on Standards for Accounting and Review Services (SSARS) (including full disclosure compilations and compilations that omit substantially all disclosures), the review captain evaluates the firm's documentation required by professional standards via reviewing background and engagement profile information, representations made by the firm and inquiries, rather than reading the actual documentation. Therefore, while documentation is being evaluated on all compilations, which wasn't done previously on report reviews, the procedures are different than in the past for compilations on Engagement Reviews. The reviewer may request to review the documentation required by professional standards on a compilation if the reviewer has cause to believe that, although the reviewed firm has represented compliance with the documentation requirements, the documentation may not have been prepared in accordance with applicable professional standards or to support presentation or measurement issues relating to the financial statements or information, if necessary.

Furthermore, although the revised Standards allow for "reading the applicable documentation required by professional standards," and the Statements on Standards for Quality Control are a part of the professional standards, it might appear that the revised Standards do not prohibit the reviewer from obtaining and reading the firm's documented quality control policies and procedures (except as specifically discussed in the revised Standards for compilation engagements performed under SSARS); however, it is deemed as beyond the scope of an Engagement Review.

#### *Technical Review and Committee Acceptance Process*

A technical review is required to be performed by the administering entity on all peer reviews. However, committee consideration is not always required in an Engagement Review. The technical reviewer should be delegated the authority from the peer review committee to accept Engagement Reviews on the committee's behalf unless there are MFCs on engagements for a review or a higher level of service, even when feedback is provided to the review captain warranting committee consideration, and circumstances leading up to the feedback may have affected the results of the review. Such peer reviews are expected to be accepted by the technical reviewer (or the committee, if it does not delegate the authority to the technical reviewer), within 45 days of receipt of the report from the reviewed firm. Peer review committee consideration will still be required in all System Reviews.

#### *Other Engagement Review Enhancements*

- The board received significant feedback on what should constitute a repeat finding in an Engagement Review. After considering this further, the board determined that when there are any disclosure deficiencies or significant deficiencies on two consecutive Engagement Reviews, for them to be considered a repeat, the disclosure deficiency(s) or significant

deficiency(s) should be the same kind or very similar and not just any back-to-back disclosure deficiency(s) or significant deficiency(s). This definition is also applicable to presentation and measurement deficiencies and significant deficiencies in an Engagement Review.

- What results in a report with a peer review rating of pass with deficiencies and a peer review rating of fail is similar to modified and adverse reports currently; however, under the revised Standards, when the exact same significant deficiency (just one) occurs on each of the engagements submitted for review, the board concluded that when there are no other significant deficiencies, a report with a peer review rating of pass with deficiencies would be issued rather than a report with a peer review rating of fail. The board believes that this is a fair and appropriate method of handling this situation.
- The description of the objective of an Engagement Review now states that it is to “evaluate” whether the engagements submitted for review were performed and reported in conformity with applicable professional standards in all material respects, rather than to “provide the reviewer with a reasonable basis for expressing limited assurance,” which is language more appropriate when discussing a system of quality control. The peer reviewer expresses no assurance on the firm’s system of quality control in an Engagement Review.
- An Engagement Review report indicates that the firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with professional standards in all material respects. Even though the reviewer’s responsibility is not to evaluate or provide any level of assurance on the firm’s system of quality control, the board believes this to be important information for inclusion in the report.
- Regarding Organizing the Peer Review Team (paragraph 29), the board considered whether use of the term *reviewer* as it relates to an Engagement Review could be confused with *reviewers* of engagements. As such, the individual responsible for an Engagement Review is now referred to as the *review captain*. [Back to exhibit B](#)

### **Other Changes Considered**

There were several other, notable items considered by the board in the development of the revised Standards, including the following:

- Setting additional minimum requirements to qualify as a peer reviewer
- Allowing committee appointed review teams (CART reviews), in addition to firm-on-firm reviews for system reviews
- Allowing an extension of time to correct deficiencies prior to finalizing the peer review report, such as the process utilized to correct PCAOB inspection findings
- Including comments in a system review report with a peer review rating of pass under very specific circumstances
- The appropriateness of the current three-year peer review cycle
- The level of services which would require a system review, such as attestation engagements
- Allowing for scope expansion in an Engagement Review

- Tailoring the Engagement Review report to describe further the scope of the peer review as it relates to the types of services a firm provides
- Utilizing a different term to name the process currently known as *peer review*

After considering the various factors involved and giving each item due and fair consideration, the board concluded that the preceding items did not require changes to the current Standards.

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