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# PCAOB Auditing Standard 7 and AICPA SQCS No. 7

## Mastering Engagement Quality and Quality Control Reviews

### A Live 110-Minute Teleconference/Webinar with Interactive Q&A

#### Today's panel features:

Dean Beddow, Senior Manager, Practice Quality Group, **Grant Thornton**, Edison, N.J.

Duane Reyhl, Member, **Andrews Hooper & Pavlik**, Saginaw, Mich.

R. Scott Lowe, Senior Manager, **Pugh & Co.**, Knoxville, Tenn.

**Wednesday, December 16, 2009**

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**1 pm Eastern**

**12 pm Central**

**11 am Mountain**

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# PCAOB Auditing Standard 7 And SQCS No. 7 Webinar

**Dec. 16, 2009**

*AS 7 Review*

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# Auditing Standard 7 – Engagement Quality Review

## Agenda

- Overview of AS 7
- Objectives of AS 7
- Qualifications of the engagement quality reviewer
- Engagement quality review
  - Performance requirements
  - Evaluation of documentation
  - Concurring approval of issuance
- Documentation of the engagement quality review

# Auditing Standard 7 – Overview

## Overview of AS 7

- PCAOB adopted AS 7 on July 28, 2009
- Supersedes interim quality control standard
- More rigorous review that enhances a firm's likelihood of finding significant deficiencies in engagements performed
- EQR and concurring approval of issuance required for every audit and review of interim financial information performed under the PCAOB standards
- Effective for fiscal years beginning on or after Dec. 15, 2009

## Auditing Standard 7 – Objective

“The objective of the engagement quality reviewer is to perform an evaluation of the significant judgments made by the engagement team and the related conclusions reached in forming the overall conclusion on the engagement and in preparing the engagement report, if a report is to be issued, in order to determine whether to provide concurring approval of issuance.”

# Auditing Standard 7 – Qualifications Of An Engagement Quality Reviewer

Reviewer must:

- Be a partner or an individual in an equivalent position within the firm or qualified individual from outside the firm
- Associated with a registered public accounting firm
- Possess the level of knowledge and competence related to accounting, auditing and financial reporting required to serve as the engagement partner
- Maintain independence
- Perform the review with integrity
- Maintain objectivity

# Auditing Standard 7 – Performance Requirements For Audits

- Evaluate significant judgments that related to planning
- Assessment of and audit responses to:
  - Significant risks identified, including fraud risks
  - Other significant risks
- Evaluate significant judgments about:
  - Materiality and disposition of identified misstatements
  - Severity and disposition of identified control deficiencies
- Review evaluation of firm's independence
- Review engagement completion document

# Auditing Standard 7 – Performance Requirements For Audits (Cont.)

- Review financial statements and other reports
- Read other information in documents containing the financial statements and evaluate whether engagement team has taken appropriate action with respect to inconsistencies or misstatements of fact
- Review consultations, including documentation thereof
- Based on procedures performed by this standard, evaluate whether appropriate matters have been communicated or identified for communication to the audit committee, management and other parties

# Auditing Standard 7 – Performance Requirements For Interim Financial Information

- Evaluate significant judgments that related to planning
- Evaluate significant judgments about:
  - Materiality and disposition of identified misstatements
  - Severity and disposition of identified control deficiencies
- Review evaluation of firm’s independence
- Review engagement completion document
- Review interim financial information for all periods presented and for the immediately preceding interim period, and other reports

## Auditing Standard 7 – Performance Requirements For Interim Financial Information (Cont.)

- Read other information in documents containing the interim financial information and evaluate whether engagement team has taken appropriate action with respect to inconsistencies or misstatements of fact
- Review consultations, including documentation thereof
- Based on procedures performed by this standard, evaluate whether appropriate matters have been communicated or identified for communication to the audit committee, management and other parties

# Auditing Standard 7 – Documentation And Concurring Approval For Issuance

- Evaluation of documentation
  - Indicates the engagement team appropriately responded to significant risks
  - Supports the conclusions reach by the engagement team
- Concurring approval of issuance
  - May provide approval only after performing with due professional care the review required by AS 7
  - Must be provided in order for the firm to grant permission to a client to use the engagement report

# Auditing Standard 7 – Documentation Of The Engagement Quality Review

- Sufficient to enable an experienced auditor, having no previous connection with the engagement, to understand the procedures performed by the engagement quality control reviewer, and others who assisted the reviewer, to comply with the provisions of the standards. Documentation should include identification of:
  - The engagement quality reviewer and his/her assistants
  - The documents reviewed during the engagement quality review
  - The date the engagement quality reviewer provided concurring approval of issuance or the reasons for not providing the approval
- Engagement quality reviewer documentation should be included with the engagement documentation

# **PCAOB Auditing Standard 7 And SQCS No. 7 Webinar**

**Dec. 16, 2009**

***SQCS No. 7 Review***

**Duane Reyhl, CPA. [duane.reyhl@ahpplc.com](mailto:duane.reyhl@ahpplc.com)  
Andrews Hooper & Pavlik P.L.C.**

# Quality Control Standard No. 7

- Effective Jan. 1, 2009
- Similarities
- Changes

# Objectives Of Quality Control

- Provide reasonable assurance
- Comply with:
  - Professional standards
  - Applicability to regulatory/legal requirements
- Issue reports that are appropriate in the circumstances

## QC System Features

- Policies designed to achieve QC objectives
- Procedures to implement and monitor compliance with those policies

## Documentation

- Document QC policies and procedures
- Extent of documentation depends on the size, structure and nature of the firm and its practice
- Address each QC element

## Communication Of QC System

- Communicate to personnel
- Written communication is preferred, but not required

## Communication Content

- Policies and procedures and their objectives
- Each individual has personal responsibility for quality and is expected to follow policies and procedures
- Importance of feedback about QC concerns

## AICPA QC Practice Aid

- Four frameworks presented:
  - Multiple-office firm
  - Single-office firm
  - Sole practitioner
  - Alternative practice structure
- Tailor templates before use
- [aicpa.org](http://aicpa.org) > Professional Resources > Peer Review > AICPA Peer Review Program

## Six QC Elements

- Leadership responsibilities
- Relevant ethical requirements
- Acceptance and continuance of client relationships and specific engagements
- Human resources
- Engagement performance
- Monitoring

# Leadership Responsibilities

- Tone at the top
- Quality is essential in performing engagements
- Establish policies and procedures to support that culture
- Commercial considerations should not override quality

# Relevant Ethical Requirements

- Communicate independence requirements
- Identify/evaluate circumstances and threats to independence
- Notify firms of breaches in independence QC
- Annual written independence confirmations

# Acceptance And Continuance

- Integrity of client
- Competent to perform and complete engagement
- Can comply with legal and ethical requirements
- Document issues identified

# Human Resources

- Recruitment and hiring
- Determining capabilities and competencies
- Assigning personnel to engagements
- Professional development
- Performance evaluation, compensation and advancement

# Engagement Performance

- Performance
- Supervision
- Review

## Engagement Performance (Cont.)

- Security of documentation
- Retention of documentation
- Consultation
- Differences of opinion
- Engagement QC review

# Engagement Quality Review

- Establish criteria that trigger an engagement QC review
- Consider:
  - Nature of engagement
  - Public interest
  - Unusual circumstances or risks
  - Laws or regulations requiring an engagement QC review

# Monitoring

- Ongoing assessment
- Assign appropriate person for:
  - Overall responsibility
  - Performance of procedures

# Monitoring – Four Objectives

Policies and procedures are:

- Relevant
- Adequate
- Operating effectively
- Complied with in practice

# Monitoring Procedures

- Review admin and personnel files
- Review engagement files
- Discuss QC with personnel
- Summarize findings
- Determine engagement corrective actions
- Communicate findings
- Consider QC changes

# Other Monitoring Assessments

- Guidance material
- Implementation of new standards
- Independence compliance
- Effectiveness of CPE and training
- Acceptance/continuance decisions
- Personnel's understanding of QC

# How Do You Do Monitoring?

- Engagement QC review
- Post-issuance reviews
- Inspection procedures

# Monitoring Documentation

- Document evidence of the operation of each QC element
- Form and content – judgment
- Retain so that peer reviewer can evaluate firm's compliance



# **PCAOB Auditing Standard 7 And AICPA SQCS No. 7 Webinar**

**Dec. 16, 2009**

***Quality Control Review Best Practices***

**Scott Lowe, Pugh and Company, P.C.  
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# Objectives

- The definition of an quality control review
- General requirements
- Establishing criteria
- General procedures
- Documentation
- Other considerations
- Budgeting
- Resolving differences in opinions





# What Is A QCR?

- A process designed to provide an objective evaluation, by an individual or individuals who are not members of the engagement team, of significant judgments the engagement team made and conclusions reached in formulating the report

# General Requirements

- A specific criteria must be established by the firm
- All engagements are to be evaluated to determine whether a quality review should be performed
- The reviewer must be a qualified independent person, or a team comprised of such individuals, none of whom is part of the engagement team
- The review must be completed prior to issuance of the report



# Establishing Criteria



- Consider the following characteristics when developing your criteria:
  - Do you consider the entity to be a high-profile client that is well known in the community?
  - Do you expect the report to be provided to the public?
  - Does the entity have a significant amount of outstanding debt?
  - Do you expect the report to be used to obtain new financing?



## Establishing Criteria (Cont.)

- Is the entity in a high-risk or regulated industry?
- Is the entity in an industry covered by one of the AICPA's quality centers?
- Does the entity enter into unusual or complex transactions?
- Is there a significant number of related-party transactions?
- Does the entity have a significant number of estimates included in the financial statements?
- Were there significant adjustments posted in the prior or current year?

# Establishing Criteria (Cont.)

- Are there any substantial fraud risk factors?
- Do you expect the report to be used in a merger or acquisition?
- Are there transactions in foreign currencies or investments in foreign entities?
- Has the entity merged or acquired a new entity?
- Is the entity a new client?
- Is the type of service provided new for the client?



# Establishing Criteria (Cont.)



- Is the engagement officer/partner new to the firm or the engagement?
- Has the entity had turnover in senior management or the primary accounting personnel?
- Has the entity experienced a material misstatement during the prior or current year?
- Was a prior period adjustment reported in the prior or current year?
- Has the entity entered a new line of business?

# Establishing Criteria (Cont.)



- Any circumstance that creates an unusual or higher level of engagement risk should be considered in establishing review criteria



# What Are The QCR Procedures?

- Consider meeting with the engagement partner to discuss the areas that are considered to be higher-risk, changes compared to prior year, and any issues the team encountered
- Read the financial statements or other information and the report; then, consider whether the report is appropriate
- Read all other reports or letters to be issued relative to the client engagement



## What Are The QCR Procedures? (Cont.)

- Review selected engagement documentation relating to the significant judgments and the conclusions reached
- Discuss significant findings and issues with the engagement officer
- The extent of the procedures may largely depend upon the complexity of the engagement and the risk that the report might not be appropriate in the circumstances

# What To Consider During The Review



- Evaluate significant judgments made, and the conclusions reached, in formulating the report
- The significant judgments may include the following:
  - Significant risks identified, and how the team responded to them
  - Judgments made with respect to the significant risks and materiality
  - Identified corrected and uncorrected misstatements, and the disposition of them
  - Matters to be communicated to management, those charged with governance, and others

# What To Consider During The Review (Cont.)



- Determine whether the workpapers selected for review reflect the work performed and the conclusions reached related to significant judgments
- Review for appropriateness the resolution and conclusions reached, regarding differences of opinion and matters requiring consultation
- Consider the evaluation of the firm's and the engagement team's independence in relation to the specific engagement

# What Must Be Documented?



- You must document that the quality control review procedures required by the firm have been:
  - Performed
  - Completed before the report is released, and
  - There are no unresolved matters

# How Does Reviewer Document Work?



- Sign off on workpapers that are reviewed
- Document discussion with engagement partner and any significant issues addressed, in a short memo
- Complete sections of any standardized programs used by the firm
- Document the date the review was performed and the approval of the report by the quality control reviewer

# Other Considerations



- Timing and communication are critical to prevent delays in issuing reports
  - The QCR may be conducted at various stages throughout the engagement, to ensure that significant issues may be resolved to the reviewer's satisfaction before the report is released
  - Communication between the engagement team, the reviewer and other personnel is critical to accommodate:
    - Scheduling
    - Meetings to resolve any questions
    - Adhering to client's deadlines

# Considerations Of The Reviewer



- Quality control reviewers must maintain appropriate ethical requirements, such as:
  - Objectivity
  - Due professional care
  - Independence

# Considerations Of The Reviewer (Cont.)



- The reviewer does not participate in the performance of the engagement except in a consulting role
  - For example, the engagement partner may consult the reviewer during the engagement to establish that a judgment made by the engagement team will be acceptable to the reviewer
  - Both the reviewer and the engagement team are careful to maintain the reviewer's objectivity
- Small firms may need to consider outsourcing this roll to another firm

# Budgeting



- Consider setting a budget for various industries
- Depending on complexity and issues encountered, a review may need more or less time
- Discuss with engagement partner when you interview them what they expect your time for review to be

# How To Resolve Differences In Opinion



- If the reviewer makes recommendations, and the engagement partner does not accept them, the firm should establish procedures to resolve the differences in opinion
- Any differences in opinion must be resolved prior to issuance of the report

Background - PCAOB Auditing Standard 7

[http://www.pcaobus.org/Rules/Docket\\_025/2009-07-28\\_Release\\_No\\_2009-004.pdf](http://www.pcaobus.org/Rules/Docket_025/2009-07-28_Release_No_2009-004.pdf)

Background - AICPA SQCS No. 7

<http://74.125.47.132/search?q=cache:mF2Dlo4hIhoJ:pcps.aicpa.org/NR/rdonlyres/2CA60EDB-9A01-4666-8B07-291D0DC407C6/0/StatementonQualityControlStandardsAB.doc+aicpa+sqcs+7&cd=2&hl=en&ct=clnk&gl=us>