

# **Quality Control Policies and Procedures**

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## Quality Control Policies and Procedures

### *Leadership Responsibilities for Quality within the Firm*

The purpose of the leadership responsibilities element of a system of quality control is to promote an internal culture based on the recognition that quality is essential in performing engagements. The following policies help the firm achieve this purpose.

1. The firm documents its QC policies and procedures and communicates them to the firm's personnel. (See paragraph .18 of QC Section 10.)
  - a. The QC partner is responsible for documenting the firm's QC policies and procedures and keeping that documentation up-to-date (reviewing at least annually).
  - b. New hires are required to acknowledge receipt of the firm's QC document in writing, and that they have been informed that failure to adhere to the firm's policies and procedures or failure to demonstrate commitment to ethical principles may result in disciplinary action.
  - c. At least annually, firm personnel receive training on the firm's QC policies and procedures, provided through informal discussions and a review of the QC document.
  - d. Training on the firm's QC policies and procedures includes the following:
    - i. A review of changes during the year.
    - ii. Open discussions on the QC document to determine which part of the policy is misunderstood or not well-known.
2. The firm's policy is to promote an internal culture that recognizes that quality is essential in performing engagements. (See paragraph .19 of QC Section 10.)
  - a. The firm promotes an internal culture that recognizes quality is essential through frequent messages to personnel about the importance of quality and that it is not sacrificed to the need to achieve profitability, and quality is considered in performance appraisals and determination of compensation.
  - b. Partners and employees are encouraged to focus on quality, regardless of time budgets.
3. The firm's leadership assumes ultimate responsibility for the firm's system of quality control. (See paragraph .19 of QC Section 10.)
  - a. The managing partner, Jim Gardner, accepts ultimate responsibility for the firm's system of quality control and for setting a tone that emphasizes the importance of quality and of following the firm's system of quality control.
  - b. The managing partner acknowledges this responsibility, and the importance of quality, through communication to firm personnel at least once a year.
4. The firm does not allow commercial considerations to override the quality of the work performed, and assigns management responsibilities accordingly.
  - a. The managing partner and each engagement partner evaluate client relationships and specific engagements so that commercial considerations do not override the objectives of the system of quality control.
  - b. The firm emphasizes to all personnel that fee considerations and scope of services should not infringe upon quality work.
5. Personnel with sufficient and appropriate experience, authority and ability are assigned responsibility for developing, implementing and operating the firm's quality control system. (See paragraph .20 of QC Section 10.)
  - a. Naomi Allen is designated as the QC partner and has overall responsibility for developing and implementing appropriate policies and procedures for the firm's quality control system.
  - b. The firm's QC partner has the following characteristics:
    - i. Sufficient and appropriate experience and competency to serve in that capacity.

- ii. Up-to-date industry-specific CPE credits in any high-risk areas he or she reviews.
- 6. The firm devotes sufficient and appropriate resources for the development, communication, and support of its quality control policies and procedures.
  - a. The firm provides the designated QC partner with sufficient time, authority, and resources to develop, implement, and maintain the firm's quality control policies and procedures.
  - b. The firm obtains feedback from personnel, such as the method for personnel to propose new or revised policies and procedures.
- 7. Performance evaluation, compensation, and advancement with regard to personnel demonstrate the firm's overarching commitment to the objectives of the system of quality control.
  - a. Quality of work and compliance with professional standards are critical components of staff development and performance evaluations.

### **Relevant Ethical Requirements**

The purpose of the relevant ethical requirements element of a system of quality control is to provide the firm with reasonable assurance that the firm and its personnel comply with relevant ethical requirements when discharging professional responsibilities. Relevant ethical requirements include independence, integrity, and objectivity. The following policies assist the firm in obtaining this assurance.

- 1. The firm and its personnel comply with relevant ethical requirements.
  - a. Jim Gardner is responsible for staying informed on relevant ethical requirements; providing guidance; answering questions; monitoring compliance; and resolving matters with respect to independence, integrity, and objectivity.
  - b. All personnel have access to current guidance materials regarding the applicable independence, integrity, and objectivity requirements through the AICPA's website. A copy of the AICPA's *Code of Professional Conduct* is also available on the firm's network.
  - c. Documentation of the resolution of ethical matters is required when consultation, including of professional literature, has occurred.
  - d. When providing non-attest services to clients for whom the firm also performs an audit, review, compilation, or attestation engagement, the firm and its personnel meet all the requirements of the "Nonattest Services" subtopic of the AICPA *Code of Professional Conduct*, and other regulatory requirements as applicable.
  - e. The firm has established and follows a process for identifying all services performed for each client and evaluating, at the attest engagement level, whether non-attest services are provided that might impair independence. The preparation of engagement letters at the onset of engagements includes a review of services, including non-attest services, to be performed.
- 2. The firm communicates its independence requirements to firm personnel and, when applicable, others subject to them. (See paragraph .22a of QC Section 10.)
  - a. The firm provides its personnel with a list of all entities with which firm personnel are prohibited from having a business relationship and informs them on a timely basis as to any changes in the firm's clients to which independence policies apply.
  - b. The firm provides reminders of professional responsibilities to personnel, such as avoiding behavior that might be perceived as impairing their independence or objectivity, as necessary and at least annually.
  - c. The firm informs its personnel of the types of financial or other relationships that may impair independence and that may be prohibited.
  - d. Annual continuing education contains required state ethics hours covering independence and ethics.

3. The firm evaluates threats to independence and objectivity, including the familiarity threat that may be created by using the same senior personnel on an audit or attest engagement over a long period of time. The firm takes appropriate action to eliminate them or reduce them to an acceptable level by applying safeguards. (See paragraph .22b of QC Section 10.)
  - a. Approval of the assignment of engagement personnel by another partner or manager is required for each audit or attestation examination. This responsibility is shared between Jim Gardner, Rob Pearson, and Naomi Allen.
  - b. New personnel assigned to the engagement are encouraged to bring a fresh perspective.
  - c. The firm considers the significance of each client to the firm. In broad terms, the significance of a client to a firm refers to relationships that could diminish a practitioner's objectivity and independence in performing attest services. In determining the significance of a client, the firm considers (a) the amount of time the partner devotes to the engagement, (b) the effect on the partner's stature within the firm as a result of his or her service to the client, (c) the manner in which the partner is compensated, and (d) the effect that losing the client would have on the partner and the firm.
  - d. When a relationship or circumstance that may create threats to compliance with the rules is identified, the firm performs procedures to evaluate threats and apply safeguards. The Conceptual Framework Toolkit is available on the firm's network.
  - e. The engagement partner considers relevant information about client engagements, including the scope of services and any changes, such as new engagements or changes in the level of service, to enable the firm to evaluate the overall impact, if any, on independence requirements. (See paragraph .23a of QC Section 10.)
  - f. The firm requires personnel to promptly notify the firm of circumstances and relationships that create a threat to independence so that appropriate action can be taken. (See paragraph .23b of QC Section 10.)
  - g. The firm compiles and communicates relevant information to appropriate personnel so that (a) the firm and its personnel can readily determine whether the firm and its personnel satisfy independence requirements; (b) the firm can maintain and update information relating to independence, and (c) the firm can take appropriate action regarding identified threats to independence that are not at an acceptable level. (See paragraph .23c of QC Section 10.)
4. Personnel notify the firm of breaches of independence requirements and the firm takes appropriate actions to resolve such situations. (See paragraph .24 of QC Section 10.)
  - a. All professional personnel are required to notify the managing partner of any potential activities involving themselves, their spouses, or their dependents that might impair independence or violate ethics rules, including services provided to entities with which firm personnel are prohibited from having a business relationship. (See paragraph .24a of QC Section 10.)
  - b. The firm has a process that protects professional personnel who report potential ethics or independence violations to the proper parties in compliance with firm policy. The firm has established a suggestion box which allows personnel to report problems noted or pose questions for the managing partner to review.
  - c. The firm determines the need for safeguards for engagements when the familiarity threat exists on an audit, review or attestation.
  - d. The firm promptly communicates identified breaches of these policies and procedures, and the required corrective actions, to the engagement partner who, with the firm, needs to address the breach and other relevant personnel in the firm and those subject to the independence requirements who need to take appropriate action. (See paragraph .24b of QC Section 10.)

- e. The engagement partner and other relevant personnel confirm to the firm that the required corrective actions have been taken (See paragraph .24c of QC Section 10.)
  - f. The managing partner is responsible for reviewing unpaid fees monthly to ascertain whether any outstanding amounts may impair the firm's independence and following up with the engagement partner.
5. The firm does not accept or withdraws from the engagement if effective safeguards to reduce threats to independence to an acceptable level cannot be applied.
- a. The firm consults internally, and with legal counsel and other parties if necessary, when the firm believes that effective safeguards to reduce threats to independence to an acceptable level cannot be applied.
  - b. The firm withdraws from the engagement when withdrawal is possible under applicable law or regulation, or does not accept the engagement, when effective safeguards to reduce threats to independence to an acceptable level cannot be applied.
6. The firm obtains written confirmation, upon hire and at least annually thereafter, of compliance with its policies and procedures regarding independence from all personnel required to be independent by relevant requirements. (See paragraph .25 of QC Section 10.)
- a. Personnel provide written representations, upon hire and on an annual basis thereafter, that they have read the firm's independence, integrity, and objectivity policies, understand the applicability of those policies to their activities, and have complied with the requirements of those policies since their last representation. Personnel review annually the most current list of all entities with which firm personnel are prohibited from having a business relationship prior to providing the written representation.
  - b. The firm's quality control partner is responsible for obtaining such written representations, reviewing independence compliance files for completeness, and resolving reported exceptions.
  - c. On each engagement, the engagement partner signs a step in the engagement program attesting to compliance with independence requirements that apply to the engagement.
7. The firm rotates personnel for audit or attest engagements for which regulatory or other authorities require such rotation after a specified period. (See paragraph .26 of QC Section 10.)
- a. The quality control partner monitors regulatory requirements for regulated entities, if any, and notifies partners of the need for rotation.

### ***Acceptance and Continuance of Client Relationships and Specific Engagements***

The purpose of the quality control element that addresses acceptance and continuance of client relationships and specific engagements is to establish criteria for deciding whether to accept or continue a client relationship and whether to perform a specific engagement for a client. The following policies relate to the firm's acceptance and continuance of client relationships and specific engagements.

1. The firm considers the risk associated with providing professional services in particular circumstances, including evaluating factors that have a bearing on management's integrity. The firm only accepts or continues engagements and client relationships when it concludes that the risk is at an acceptable level. (See paragraph .27-.28 of QC Section 10.)
- a. The firm informs personnel, through discussion, of the firm's policies and procedures for accepting and continuing clients, and that they are expected to be familiar with the firm's policies and procedures for the acceptance and continuance of clients, including who in the firm is authorized to accept engagements on behalf of the firm.
  - b. The firm communicates with the predecessor auditor as required, and considers communicating with the predecessor accountant when recommended, by professional

- standards. This communication includes inquiries regarding the nature of any disagreements and whether there is evidence of opinion-shopping.
- c. The firm obtains and evaluates relevant information before accepting or continuing any client, such as the following:
    - i. The nature and purpose of the services to be provided and management's understanding thereof
    - ii. The identity of the client's principal owners, key management, related parties, and those charged with its governance
    - iii. The nature of the client's operations, including its business practices, from sources such as annual reports, interim financial statements, reports to and from regulators, and income tax returns
    - iv. Information obtained from inquiries of third parties about the client, its principal owners, key management, and those charged with governance that may have a bearing on evaluating the client. Examples of such third parties are bankers, factors, legal counsel, credit services, investment bankers, underwriters, and other members of the financial or business community who may have applicable knowledge.
    - v. Information, from discussion with the client and inquiries of others, concerning the attitude of the client's principal owners, key management, and those charged with its governance toward such matters as aggressive interpretation of accounting standards, compliance with laws and regulations, and internal control over financial reporting.
  - d. The firm evaluates the risk of providing services to significant clients or to other clients for which the firm's objectivity or the appearance of independence may be impaired. The firm takes appropriate safeguards, if necessary, or if safeguards cannot reduce the threat to objectivity and independence to an acceptably low level, the firm does not accept the engagement.
  - e. If a potential conflict of interest is identified in accepting an engagement from a new or existing client, the firm determines whether it is appropriate to accept the engagement. If issues have been identified and the firm decides to accept or continue the client relationship or a specific engagement, the firm considers whether ethical requirements included in the "Conflicts of Interest for Members in Public Practice" interpretation (AICPA Professional Standards, ET sec. 1.110.010), apply, such as disclosure of the relationship to the client and other appropriate parties, and documents how the issues were resolved.
  - f. The firm considers the timing of the acceptance of the engagement and how that affects the firm's ability to perform all procedures necessary for the engagement, such as inventory observation for example.
2. The firm evaluates whether the engagement can be completed with professional competence; undertakes only those engagements for which the firm has the capabilities, resources, and professional competence to complete; and evaluates, at the end of specific periods or upon occurrence of certain events, whether the relationship should be continued. (See paragraph .27 of QC Section 10.)
    - a. If the engagement is for a level of service that the firm is not currently providing, the firm considers the implications for obtaining the necessary competency and the implications for Peer Review.
    - b. The firm defines high-risk engagements based on the characteristics of the firm and considers the following criteria in determining whether the engagement is high-risk:
      - i. Whether the client is in a specialized industry and the extent of the firm's experience in this area.

- ii. Whether the client is in a new industry for the firm.
  - iii. Whether new or specialized accounting pronouncements apply to the client.
  - iv. Whether new professional standards apply to the firm relating to the engagements.
  - v. Whether the firm's resources are inadequate to complete the engagements.
  - vi. Whether certain conditions exist at the entity, including aggressive earnings management, unreliable accounting processes, and questions regarding the entity's ability to continue as a going concern.
  - vii. Whether the entity is in the development stage.
- c. The firm accepts engagements that meet the firm's criteria as high-risk only when the firm has or is willing to make the investment to acquire the necessary competency. The firm acknowledges that accepting a high-risk engagement entails assigning more experienced staff, may necessitate the use of external resources, and requires that an EQCR be performed.
- d. The firm evaluates whether the firm has, or can reasonably expect to obtain, the knowledge and expertise necessary to perform the engagement, including relevant regulatory or reporting requirements.
- e. The firm's general practice is to not accept high-risk engagements or engagements that require an inordinate amount of time and/or resources to complete relative to the firm's available resources. The firm determines that the following are in place before accepting an engagement:
- i. Sufficient personnel with the necessary capabilities and competence.
  - ii. Sufficient technical resources available to engagement personnel.
  - iii. Whether specialists will be needed and, if so, will be available.
  - iv. The firm is able to complete the engagement within the reporting deadline.
- f. The firm obtains relevant information to determine whether the relationship should be continued and evaluates the decision at least annually, as part of finalizing the current year engagement and a final evaluation before the engagement letter is sent for the next year engagement, considering conditions such as:
- i. Aggressive earnings management, unreliable accounting processes, or going concern questions that exist at the entity.
  - ii. The client is delinquent in paying fees.
  - iii. The firm is unable to meet the client's deadlines.
  - iv. The services required have grown beyond the firm's ability to deliver.
  - v. The firm is unable to obtain the necessary resources to carry out the engagement.
  - vi. Internal or external inspections have indicated deficiencies in the execution of the engagement or similar engagements.
  - vii. The client has ignored prior recommendations, such as those that address deficiencies in internal control.
- g. When significant changes or triggering events (such as changes in management, or changes in the nature or scope of the engagement) occur, the firm reevaluates the decision to accept or continue an engagement or client relationship.
- h. When making the decision, the engagement partner assesses the information obtained about the client or engagement and makes a recommendation about whether to accept or continue the engagement to the other partners of the firm. A majority of the firm's partners are involved in the decision-making process.
- i. When the firm becomes aware of information that would have caused the firm to decline the engagement if the information had been available earlier, the firm considers the professional and legal responsibilities that apply to the circumstances, including whether



there is a requirement for the firm to report to regulatory authorities, and the firm considers whether to withdraw from the engagement or from the client relationship.

- j. The engagement partner documents evidence of consideration and approval of engagement acceptance or continuance in the planning section of the engagement documentation.
3. The firm obtains an understanding with the client regarding the services to be performed. (See paragraph .29 of QC Section 10.)
  - a. The firm prepares a written engagement letter for each engagement, documenting the understanding with the client regarding the nature, scope, and limitations of the services to be performed. The firm obtains the client's signature on that letter before significant resources are committed to the engagement.
  - b. Any changes in the nature or scope of the engagement are communicated to the client in writing.
4. The firm has established procedures on withdrawal from an engagement or from both the engagement and the client relationship, as follows: (See paragraph .30 of QC Section 10.)
  - a. The firm considers whether there is a professional, regulatory, or legal requirement for the firm to remain in place or for the firm to report to regulatory authorities the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal.
  - b. If the firm determines that it is appropriate to withdraw, the firm discusses with the appropriate level of the client's management and those charged with its governance withdrawal from the engagement, or from both the engagement and the client relationship.
  - c. The firm considers the implications for previous engagements with this client, including the need to withdraw previously issued reports.
5. The firm documents how issues relating to acceptance or continuance of client relationships were resolved on the engagement acceptance and continuance form in the planning section of the engagement documentation.

### ***Human Resources***

The purpose of the human resources element of a system of quality control is to provide the firm with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary to perform its engagements in accordance with professional standards and regulatory and legal requirements, and to enable the firm to issue reports that are appropriate in the circumstances. The following policies help to obtain this assurance.

1. The firm has sufficient personnel with the competence, capabilities, and commitment to ethical principles necessary to perform engagements in accordance with professional standards and applicable legal and regulatory requirements and enable the firm to issue reports that are appropriate in the circumstances. (See paragraph .31 of QC Section 10.)
2. The firm hires only personnel that have the characteristics to enable them to perform competently.
  - a. The firm's partners share responsibility for the firm's hiring and human resources management, including evaluation of personnel needs; establishment of hiring objectives based on factors such as existing clientele, anticipated growth, turnover, and advancement. Rob Pearson is designated as the human resource (HR) partner and provides final approval on hiring personnel.
  - b. Discussion among partners includes identifying personnel needs at all levels.
  - c. The firm identifies sources of employment candidates, such as universities and recruiters.

- d. The HR partner is responsible for interviewing candidates and determining when other partners will be involved in the interviewing process. The HR partner must acquire adequate training in interviewing techniques.
3. The firm determines capabilities and competencies required for an engagement, including those required of the engagement partner. (See paragraph .33 of QC section 10.)
  - a. The following knowledge, skills, and abilities (competencies) are required for the engagement partner for each of the firm's accounting, auditing or attestation engagements:
    - i. An understanding of the role of the firm's system of quality control and the AICPA Code of Professional Conduct.
    - ii. An understanding of the performance, supervision, and reporting aspects of the engagement.
    - iii. An understanding of the applicable accounting, auditing, or attestation professional standards, including those standards directly related to the industry in which a client operates.
    - iv. An understanding of the industry in which a client operates, including the industry's organization and operating characteristics, so as to assess the risks associated with an engagement.
    - v. Skills that indicate sound professional judgment, including the ability to exercise professional skepticism.
    - vi. An understanding of how organizations are dependent on or enabled by information technologies, and the manner in which information systems are used to record and maintain financial information.
4. The firm determines the capabilities and competencies possessed by personnel. (See paragraph .34 of QC section 10.)
  - a. The firm evaluates personal characteristics such as integrity, competence, and motivation of personnel on an ongoing basis.
  - b. The firm periodically evaluates all personnel, including owners, who sign reports on behalf of the firm to assess whether they possess the knowledge, skills, and abilities (competencies) necessary to enable them to be qualified to perform the firm's accounting, auditing, or attestation engagements.
5. The firm assigns responsibility for each engagement to an engagement partner. The identity and role of the engagement partner are communicated to management and those charged with governance; the engagement partner has the appropriate competence, capabilities, and authority to perform the role; and the responsibilities of the engagement partner are clearly defined and communicated to that individual. (See paragraph .33 of QC section 10.)
  - a. Responsibility for each engagement is assigned to an engagement partner who has the appropriate capabilities, competence, authority, and time to perform the role.
  - b. The identity and role of the engagement partner are communicated to management and those charged with governance at the beginning of the engagement, typically in the engagement letter.
  - c. The responsibilities of an engagement partner are clearly defined and communicated to the engagement partner by the other firm partners.
  - d. When an engagement is found to be materially non-conforming after report issuance, the firm
    - i. Requires the engagement partner to take appropriate training and monitors that person's performance until the firm is satisfied that remediation has occurred;
    - ii. Limits or prohibits the engagement partner's assignments on future engagements in that industry or area; or
    - iii. Dismisses the engagement partner from the firm.

6. The firm assigns appropriate personnel with the necessary competence and capabilities to perform engagements in accordance with professional standards and applicable legal and regulatory requirements and enable the firm to issue reports that are appropriate in the circumstances. (See paragraph .34 of QC section 10.)
  - a. The firm assigns personnel (including partners) to engagements based on the knowledge, skills, and abilities required in the circumstances and the nature and extent of supervision required.
  - b. Engagement partners are responsible for the assignment of personnel to engagements, and considers the following factors to determine how personnel are assigned to engagements:
    - i. Engagement size and complexity
    - ii. Specialized experience or expertise required
    - iii. Personnel availability and involvement of supervisory personnel
    - iv. Timing of the work to be performed
    - v. Continuity and rotation of personnel
    - vi. Opportunities for on-the-job training
    - vii. Previous knowledge
    - viii. Skills and abilities (competencies) gained through other experience
    - ix. Situations in which independence or objectivity concerns exist.
  - c. In the case of high-risk or significant client engagements, the managing partner is required to approve partner assignments.
  - d. The firm assures that individuals are maintaining the appropriate licenses to perform their assigned engagements, including for states other than where the individual primarily practices public accounting.
  - e. When the firm accepts an audit in an industry in which the firm's personnel do not have recent experience, the firm consults appropriate resources (for example: literature, the AICPA Technical Hotline, or a suitably qualified external person) to determine the extent of changes relevant to the engagement. When determined to be necessary, the firm engages a suitably qualified external person to assist with the performance of an audit as a member of the engagement team.
  - f. The firm maintains the appropriate firm license(s) or permit(s), including for states other than where its main office is domiciled.
  - g. In all states where the firm practices, the firm:
    - i. Is licensed under the same name under which it practices,
    - ii. Must obtain license(s) or permit(s) which are effective before any reports are issued in the state,
    - iii. Considers variations in licensing bodies' rules and regulations and how they affect the firm's need to be licensed in that state, and
    - iv. Addresses any restrictions on practice imposed by the licensing bodies.
7. Personnel, including partners, participate in general and industry-specific continuing professional education (CPE) and professional development activities that enable them to accomplish assigned responsibilities and satisfy applicable CPE requirements of the AICPA, state CPA societies, state boards of accountancy, and other regulators.
  - a. Individuals are responsible for meeting their CPE and professional development activities, including maintaining CPE records and course materials for personnel; the QC partner is responsible for ensuring these requirements are met.
  - b. The firm encourages personnel to pass the Uniform CPA Examination and covers the cost, including paid time off to take the exam.
  - c. The firm has an orientation policy for new hires.

- d. The firm informs personnel of their responsibilities and professional opportunities.
  - e. The firm provides CPE to personnel in subjects that are relevant to their responsibilities, either through in-house programs or externally developed courses.
  - f. All personnel must comply with the professional education requirements of the board(s) of accountancy in state(s) where they are licensed and, as applicable, the AICPA, the state CPA society, and *Government Auditing Standards*—the Yellow Book.
  - g. The firm establishes CPE requirements for professional personnel. Under these requirements
    - i. All professional personnel must participate in CPE and professional development activities that support their performance in their assigned engagements and are appropriate when considering their role in the firm.
    - ii. If an individual signs opinions on or manages engagements in a specialized industry or area, the individual must have a minimum of eight hours of CPE specific to the industry or area every three years.
    - iii. All personnel must take ethics CPE, as required by state law.
  - h. The firm reimburses personnel who are CPAs for membership in a state society and the AICPA, and other memberships, as relevant.
  - i. The firm informs personnel of changes in accounting and auditing standards, independence, integrity, and objectivity requirements.
  - j. The firm encourages personnel to participate in professional development activities.
8. Personnel selected for advancement have the qualifications to fulfill the responsibilities they will be called on to assume. (See paragraph .32 of QC section 10.)
- a. The firm's partners share responsibility for evaluating personnel at each professional level, reviewing evaluations with personnel, and for advancement to the next higher level of responsibility.

### **Engagement Performance**

The purpose of the engagement performance element of quality control is to provide the firm with reasonable assurance (a) that engagements are consistently performed in accordance with applicable professional standards and regulatory and legal requirements and (b) that the firm or the engagement partner issues reports that are appropriate in the circumstances. Policies and procedures for engagement performance should address all phases of the design and execution of the engagement, including engagement performance, supervision responsibilities and review responsibilities. Policies and procedures also should require that consultation takes place when appropriate. In addition, a policy should establish criteria against which all engagements are to be evaluated to determine whether an engagement quality-control review should be performed. The following policies and procedures for engagement performance help to obtain this assurance.

- 1. The firm uses quality control materials (QCM), including audit guides, standardized forms, checklists, practice aids, and questionnaires, to assist with engagement performance. (See paragraph .35 of QC section 10.)
  - a. The firm obtains much of its QCM through a third-party provider (PPC).
  - b. The firm QC partner is responsible for ensuring that the firm's QCM is up to date, reliable, and appropriate for the engagement.
- 2. Planning for engagements meets professional, regulatory and the firm's requirements.
  - a. The firm provides personnel with the firm's practice aids that prescribe the factors the engagement team should consider in the planning process and the extent of documentation of those considerations.

- b. The firm trains personnel on the use of the firm's practice aids.
  - c. Planning considerations vary depending on the size and complexity of the engagement.
    - i. If the firm accepts an audit, review or attestation examination in an industry in which the firm's personnel do not have recent experience, the firm requires senior engagement team members to take industry-specific CPE before planning procedures are performed.
    - ii. The engagement partner accepts responsibility for planning the engagement.
    - iii. Appropriate personnel are assigned responsibilities during the planning phase.
    - iv. The engagement partner, or designated personnel, develops or updates background information on the client and the engagement.
  - d. The engagement team prepares planning documentation that includes the following:
    - i. Proposed work programs tailored to the specific engagement
    - ii. Staffing requirements
    - iii. Whether there is a need for specialized knowledge and how that will be obtained
    - iv. Consideration of the economic conditions affecting the client and its industry and their potential effect on the conduct of the engagement
    - v. Consideration of risks, including fraud considerations, affecting the client and the engagement and how they may affect the procedures to be performed
    - vi. Approval of planning and of the proposed work program by the engagement partner before work to obtain engagement evidence begins
3. The engagement is performed, supervised, documented, and reported in accordance with the requirements of professional standards, applicable regulators, and the firm.
- a. Each engagement is assigned an engagement partner who accepts ultimate responsibility for the engagement.
  - b. A written work program is used in each engagement.
  - c. Each engagement is required to be supervised by suitably experienced engagement team members. Engagement supervision includes the following:
    - i. Briefing the engagement team on the objectives of their work.
    - ii. Tracking the progress of the engagement.
    - iii. Considering the competence and capabilities of individual members of the engagement team, whether they have sufficient time to carry out their work, whether they understand their instructions, and whether the work is being carried out in accordance with the planned approach to the engagement.
    - iv. Addressing significant findings and issues arising during the engagement, considering their significance, and modifying the planned approach appropriately
    - v. Identifying matters for consultation or consideration by more experienced engagement team members during the engagement.
  - d. Engagement personnel prepare working papers that adhere to the firm's guidelines, applicable regulatory requirements and professional standards for the form and content of documentation of the work performed and conclusions reached.
  - e. Engagement documentation makes clear when and by whom engagement documentation was prepared and reviewed.
4. Qualified engagement team members review work performed by other team members on a timely basis. (See paragraph .36 of QC section 10.)
- a. The firm's methodology is for all audit work to be reviewed by other staff assigned to the engagement or by a manager or partner level engagement member. The engagement partner is responsible for the final review.
  - b. For each engagement, there is evidence of appropriate review of documentation of the work performed, conclusions reached, the financial statements, and the report.

- c. The firm prescribes the extent of review of the nature, timing and extent of procedures performed to have reasonable assurance that they are consistent with the approach described in the planning documentation. Exceptions are investigated and resolved.
  - d. Engagement documentation is reviewed to determine whether the following have occurred:
    - i. The work has been performed in accordance with professional standards and applicable legal and regulatory requirements.
    - ii. Significant findings and issues have been raised for further consideration.
    - iii. Appropriate consultations have taken place and the resulting conclusions have been documented and implemented.
    - iv. The nature, timing, and extent of the work performed is appropriate and without need for revision.
    - v. The work performed supports the conclusions reached and is appropriately documented.
    - vi. The evidence obtained is sufficient and appropriate to support the report.
    - vii. The objectives of the engagement procedures have been achieved.
5. The firm has criteria for determining whether an EQCR should be performed, evaluates all engagements against the criteria, performs an EQCR for all engagements that meet the criteria, and completes the review before the report is released. (See paragraphs .38-.40 of QC section 10.)
- a. The firm's criteria for requiring that an EQCR be performed include:
    - i. An engagement quality control review is required by law or regulation.
    - ii. A high-risk engagement, as defined by the firm, using the same criteria used for acceptance and continuance.
    - iii. An engagement in an industry in which the firm's practice is limited and the firm's personnel have little or no experience.
  - b. The firm evaluates all engagements against the criteria and performs an EQCR for all engagements that meet this criteria.
6. Engagement quality control reviewers meet the firm's criteria for eligibility. (See paragraph .42-44 of QC section 10.)
- a. The engagement quality control reviewer meets the following criteria:
    - i. Has sufficient technical expertise and experience.
    - ii. Carries out his or her responsibilities with objectivity and due professional care without regard to the relative positions of the audit engagement partner and the engagement quality control reviewer. If the reviewer's objectivity becomes impaired, the reviewer must be replaced.
    - iii. Does not make decisions for the engagement team or participate in the performance of the engagement except to serve as a consultant to the engagement partner at any stage during the engagement, with the understanding that the engagement quality control reviewer's objectivity may be impaired if the nature and extent of consultations becomes significant.
    - iv. Does not assume any of the responsibilities of the engagement partner or have responsibility for the audit of any significant affiliated or related entities.
    - v. Meets the independence requirements relating to the engagements reviewed, even though the engagement quality control reviewer is not a member of the engagement team.
  - b. When the firm does not have suitably qualified personnel to perform the EQCR, the firm contracts with a suitably qualified external person to perform the engagement quality control review.
7. The firm establishes procedures addressing the nature, timing, extent, and documentation of the EQCR. (See paragraph .40 of QC section 10.)

- a. For engagements that meet the firm's criteria for having an EQCR performed, the engagement partner:
    - i. Determines that an engagement quality control reviewer has been appointed;
    - ii. Discusses with the engagement quality control reviewer the significant findings or issues that arose during the engagement, if any; and
    - iii. Does not release the report until the completion of the EQCR.
  - b. An EQCR is not necessary to obtain sufficient appropriate audit evidence for audit engagements; therefore, the EQCR does not need to be completed before the date of the auditor's report. However, when additional audit procedures must be performed as a result of an EQCR, the date of the auditors' report is updated to the date by which sufficient appropriate audit evidence has been obtained.
  - c. The firm's procedures require that for audit and examination engagements, the engagement quality control reviewer do the following (See paragraph .41 of QC section 10.):
    - i. Discuss significant accounting, auditing, and financial reporting issues with the engagement partner, including matters for which there has been consultation.
    - ii. Discuss with the engagement partner the engagement team's identification and audit of high-risk assertions, transactions and account balances.
    - iii. Confirm with the engagement partner that there are no significant unresolved issues.
    - iv. Review selected working papers relating to the significant judgments the engagement team made and the conclusions they reached.
    - v. Review documentation of the resolution of significant accounting, auditing or financial reporting issues, including documentation of consultation with firm personnel or external sources.
    - vi. Review the summary of uncorrected misstatements related to known and likely misstatements.
    - vii. Review additional engagement documentation to the extent considered necessary.
    - viii. Read the financial statements and the report and consider whether the report is appropriate.
    - ix. Complete the review before the release of the report.
    - x. Determine whether the issues raised in the review require additional procedures that necessitate changing the auditors' report date.
  - d. The EQCR is documented and includes the following:
    - i. That the procedures required by the firm's policies on EQCR have been performed.
    - ii. That the EQCR has been completed before the report is released.
    - iii. An assertion that the reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments the engagement team made and the conclusions it reached were not appropriate.
8. The firm requires that consultation take place when appropriate; that sufficient and appropriate resources are available to enable appropriate consultation to take place; that all the relevant facts known to the engagement team are provided to those consulted; that the nature, scope, and conclusions of such consultations are documented; and that conclusions resulting from such consultations are implemented. (See paragraph .37 of QC section 10.)
- a. The firm informs personnel of its consultation policies and procedures.
  - b. Under the following circumstances, firm personnel are expected to consult:
    - i. Application of newly issued technical pronouncements.

- ii. Industries with special accounting, auditing or reporting requirements.
  - iii. Emerging practice problems.
  - iv. Choices among alternative generally accepted accounting principles upon initial adoption or when an accounting change is made.
  - v. Reissuance of a report, consideration of omitted procedures after a report has been issued or subsequent discovery of facts that existed at the time a report was issued.
  - vi. Filing requirements of regulatory agencies.
- c. The firm requires the engagement partner (with sufficient experience) to determine the need to consult based on the following:
- i. The materiality of the matter.
  - ii. The experience of senior engagement personnel in a particular industry or functional area.
  - iii. Whether the financial reporting framework or professional standards applicable to the engagement are as follows:
    - 1. Based on authoritative pronouncements that are subject to varying interpretations.
    - 2. Based on varied interpretations of prevailing practice.
    - 3. Under active consideration by an authoritative body.
- d. The firm maintains and provides its personnel access to adequate and current reference materials, including materials relevant to its clients. Those materials include the most current versions of the following:
- i. AICPA Professional Standards
  - ii. AICPA Audit and Accounting guides relevant to all industries in which the firm practices
  - iii. FASB pronouncements
  - iv. GASB pronouncements
  - v. Governmental Auditing Standards (the Yellow Book)
  - vi. And other audit guides relevant to the firm's practice
- e. Those consulted are provided with all relevant facts that will enable them to provide informed advice.
- f. The firm resolves any differences of opinion regarding matters consulted on prior to report issuance.
- g. The firm requires documentation of consultations that are deemed to be significant by the engagement partner. That required documentation included the following:
- i. All relevant facts and circumstances
  - ii. References to professional literature used in the determination.
  - iii. Conclusions reached and how they were implemented
  - iv. Sign-off of engagement partner and consultant, if any
  - v. Reference to engagement workpaper
- h. Firm personnel are encouraged to consult individuals within the firm if matters have been identified for consultation. If matters cannot be resolved, firm personnel are encouraged to consult with outside parties, including other firms, attorneys, professional associations, or regulatory bodies. Before using such services, the firm evaluates whether the external provider is qualified for that purpose.
9. The firm addresses and resolves differences of opinion within the engagement team, with those consulted, and when applicable, between the engagement partner and the engagement quality control reviewer. (See paragraph .46-.48 of QC section 10.)



- a. The firm follows procedures for consultation in resolving differences within an engagement team. If further action is necessary, the engagement and the QC partner, and the firm's leadership, if necessary, resolve the differences.
  - b. The conclusion reached to resolve the matter of disagreement and how that conclusion was implemented are documented.
  - c. The firm will not release the report until any differences of opinion are resolved.
  - d. Any party to the consultation or difference of opinion who disagrees with the final conclusion may document his or her disagreement with, and disassociate themselves from, the resolution of the matter. (See paragraph .47 of QC section 10.)
10. Engagement teams complete the assembly of final engagement files on a timely basis (See paragraph .49 of QC section 10.)
- a. Final engagement files are assembled by the earlier of time limits required by professional standards and applicable regulatory requirements, if any, or 60 days from the report release date.
11. The firm maintains the confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation. (See paragraph .50 of QC section 10.)
- a. Adequate and appropriate controls over the confidentiality, custody, integrity, accessibility and retrievability of engagement documentation include the following:
    - i. Requiring that engagement documentation clearly indicates when and by whom it was prepared and reviewed
    - ii. Procedures to protect the integrity of the information at all stages of the engagement, especially when the information is shared within the engagement team or transmitted to other parties via electronic means
    - iii. Procedures to prevent unauthorized changes to the engagement documentation. For electronic engagement documentation this includes
      - 1. Using passwords or data encryption or both, to restrict access to authorized users
      - 2. Using appropriate back-up routines at appropriate stages during the engagement
    - iv. Procedures for tracking the distribution of engagement documentation materials to personnel at the start of the engagement, preparing engagement documentation during the engagement and assembling final documentation at the end of the engagement
    - v. Procedures to allow access to paper engagement documentation for the engagement team and other authorized users, and restrict access by others
    - vi. Maintaining engagement documentation in one location to enhance retrievability (this applies to both hardcopy and electronic documentation, although back-up files would be maintained elsewhere)
    - vii. Implementing procedures regarding original paper documents that have been electronically scanned or otherwise copied to another media that accomplish the following:
      - 1. Generate copies that contain the entire content of the original paper documentation, including manual signatures, cross-references and annotations
      - 2. Integrate the copies into the engagement files, including indexing and signing off on the copies as necessary
12. The firm retains engagement documentation for a period of time sufficient to meet the needs of the firm, professional standards, laws and regulations. (See paragraph .51 of QC section 10.)

- a. The quality control partner maintains a list specifying the period of time sufficient to meet the needs of the firm, the requirements of the state board(s) of accountancy and applicable professional standards, for each level of engagement service
- b. Engagement documentation is retained for the specified period of time

## **Monitoring**

The purpose of the monitoring element of a system of quality control is to provide the firm and its engagement partners with reasonable assurance that the policies and procedures related to the system of quality control are relevant, adequate, operating effectively, and complied with in practice. Monitoring involves an ongoing consideration and evaluation of the appropriateness of the design, the effectiveness of the operation of a firm's quality control system, and a firm's compliance with its quality control policies and procedures. The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of the following:

- Adherence to professional standards and regulatory and legal requirements.
- Whether the quality control system has been appropriately designed and effectively implemented.
- Whether the firm's quality control policies and procedures have been operating effectively so that reports that are issued by the firm are appropriate in the circumstances.

The following policies help the firm achieve this purpose.

1. The firm should establish a monitoring process designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively. (See paragraph .52 of QC section 10.)
2. The firm assigns responsibility for the firm's monitoring process, including performance, to the QC partner. (See paragraph .52b of QC section 10.)
  - a. The firm determines that the QC partner and all others responsible for conducting monitoring procedures
    - i. Have sufficient training, experience and competence to execute their responsibilities;
    - ii. Have no history of limitations or restrictions on their ability to practice public accounting; and
    - iii. Have not acted as engagement partner on one or more materially non-conforming engagements that were uncovered through peer review, monitoring, or regulatory inspection.
  - b. The QC partner is responsible for determining that the firm's quality control policies and procedures and its methodologies remain relevant and adequate. Factors that may be considered include the following:
    - i. External factors, such as changes in professional standards or other regulatory requirements applicable to the firm's practice, changes in applicable AICPA membership requirements, and mergers/divestitures of portions of the practice.
    - ii. Internal indicators, such as results of inspections and peer reviews, and review of litigation and regulatory enforcement actions against the firm and its personnel.
  - c. At least annually the QC partner performs, or selects an individual or team to perform, inspection procedures on the firm's quality control system

- d. The QC partner uses criteria established by the firm to determine that individuals responsible for the inspection and other monitoring procedures have sufficient experience and authority to assume that responsibility
  3. The firm performs monitoring procedures that are sufficiently comprehensive to enable the firm to assess compliance with all applicable professional standards and all elements of the firm's quality control policies and procedures.
    - a. Inspections are performed in conjunction with a peer review conducted under standards established by the AICPA. The inspection process includes a review of engagement working papers, reports, and clients' financial statements.
    - b. Inspection procedures include review of engagements that represent a reasonable cross-section of the firm's accounting and auditing practice using criteria, which could include but are not limited to, the following:
      - i. Engagements performed under Government Auditing Standards
      - ii. Initial engagements
      - iii. Specialized industries, if any, with emphasis given to high risk engagements
      - iv. An appropriate cross-section of the firm's auditing and accounting partners
      - v. Engagements with areas that have been identified as findings in peer reviews or prior internal inspections
    - c. The selected engagements are reviewed for compliance with the firm's policies and procedures.
    - d. When deficiencies are identified in engagements, the QC partner considers the need to expand the selection of engagements to assist in determining whether the deficiencies noted are systemic or repetitive.
    - e. In addition to engagement inspection and reviews, the firm's monitoring procedures include performing appropriate tests of compliance with the firm's policies and procedures on a sample basis, including:
      - i. Assessing the appropriateness, reliability and suitability of the firm's guidance materials and practice aids, such as audit programs, forms and checklists, and determining whether they reflect recent professional pronouncements. This assessment includes soliciting comments from professional personnel as to the effectiveness of practice aids and tools.
      - ii. Issuing guidance regarding new professional standards, regulatory requirements, and related changes to firm policy through informational meetings and as-needed discussions among personnel.
      - iii. Reviewing correspondence regarding the resolution of independence and client acceptance matters within the practice office.
      - iv. Reviewing the resolution of matters reported by professional personnel regarding independence to determine that matters have been appropriately considered and resolved.
      - v. Reviewing summaries of CPE records for personnel to track compliance with the requirements of the AICPA, state societies, GAO and other regulatory bodies.
      - vi. Reviewing professional development activities to determine whether they are appropriate, effective, and meet the needs of the firm.
      - vii. Soliciting information from personnel during meetings and informal discussions regarding the effectiveness of training programs and professional development activities.
4. The firm communicates (a) deficiencies noted as a result of the monitoring process and recommendations for appropriate remedial action to relevant engagement partners and other

appropriate personnel, and (b) the results of the monitoring of its quality control system process to relevant firm personnel at least annually. (See paragraph .55 of QC section 10.)

- a. For each engagement reviewed, the monitoring individual is responsible for (a) identifying and summarizing the deficiencies noted, and (b) discussing the results of the inspection or review with the engagement partner and other appropriate personnel responsible for each engagement selected for review and determining whether any corrective action needs to be taken or improvements made with respect to those specific engagements. (See paragraph .55 of QC section 10.)
  - b. At the conclusion of the inspection or review, the QC partner and monitoring individual are responsible for evaluating the effect of deficiencies noted as a result of the monitoring process and determining whether they are systemic, repetitive or other significant deficiencies that require prompt corrective action. (See paragraph .54 of QC section 10.)
  - c. Recommendations for appropriate corrective actions include one or more of the following:
    - i. Taking appropriate corrective action in relation to an individual engagement or member of personnel.
    - ii. The communication of the findings to those responsible for training and professional development.
    - iii. Changes to the quality control policies and procedures.
    - iv. Disciplinary action against those who fail to comply with the policies and procedures of the firm, especially those who do so repeatedly. (See paragraph .56 of QC section 10.)
  - d. When the results of the monitoring procedures (through firm monitoring, peer review or regulatory inspection) indicate that a report may be inappropriate or that procedures were omitted during the performance of the engagement, the firm
    - i. Determines what further action is appropriate to comply with relevant professional standards and legal and regulatory requirements;
    - ii. Considers whether to obtain legal advice; and
    - iii. Takes and documents the appropriate action.The firm documents the actions taken. (See paragraph .57 of QC section 10.)
  - e. The firm prepares a monitoring report that summarizes (a) the monitoring procedures performed, (b) the conclusions reached from such procedures, (c) any systemic, repetitive or other significant deficiencies noted, and (d) recommended remedial actions. (See paragraph .58 of QC section 10.)
  - f. The partners review the recommended corrective actions and reach final conclusions regarding the actions to be taken.
5. The firm deals appropriately with complaints and allegations. (See paragraph .61-.62 of QC section 10.)
- a. The firm consults with legal counsel or its professional liability insurance carrier as necessary.
6. The firm prepares appropriate documentation to provide evidence of the operation of each element of its system of quality control. (See paragraph .62 of QC section 10.)
- a. The firm documents the performance of each element of its QC system on an ongoing basis.
  - b. The firm documents its monitoring of the QC system through the firm's summary monitoring report, manual notes, checklists, and forms.
7. The firm retains documentation providing evidence of the system of quality control for an appropriate period of time. (See paragraph .63 of QC section 10.)
- a. The firm retains monitoring documentation for a time sufficient to allow those monitoring the QC system, including peer reviewers, to evaluate the firm's compliance with its system.

The firm generally retains such documentation until the next peer report has been completed.

**Appendix**  
**QC Section 10**  
***A Firm's System of Quality Control***

## QC Section 10

# A Firm's System of Quality Control

(Supersedes SQCS No. 7.)

Source: SQCS No. 8; SAS No. 122; SAS No. 128.

Effective date: Applicable to a CPA firm's system of quality control for its accounting and auditing practice as of January 1, 2012.

## Introduction

### Scope of This Section

.01 This section addresses a CPA firm's responsibilities for its system of quality control for its accounting and auditing practice. This section is to be read in conjunction with the AICPA Code of Professional Conduct and other relevant ethical requirements.

.02 This section, although applicable to audit and attestation engagements performed by CPA firms in accordance with *Government Auditing Standards*, does not apply to government audit organizations. Instead, those government audit organizations are subject to the quality control and assurance requirements of *Government Auditing Standards*, which are similar to those of this section.

.03 Other professional standards set out additional requirements and guidance on the responsibilities of firm personnel regarding quality control procedures for specific types of engagements. AU-C section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, for example, addresses quality control procedures for engagements conducted in accordance with generally accepted auditing standards. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

.04 A system of quality control consists of policies designed to achieve the objective set out in paragraph .12 and the procedures necessary to implement and monitor compliance with those policies.

### Authority of the SQCSs

.05 This section applies to all CPA firms with respect to engagements in their accounting and auditing practice. The nature and extent of the policies and procedures developed by an individual firm to comply with this section will depend on various factors, such as the size and operating characteristics of the firm and whether it is part of a network.

.06 Statements on Quality Control Standards (SQCSs) contain the objective of the firm in following the SQCSs and requirements designed to enable the firm to meet that stated objective. In addition, SQCSs contain related guidance in the form of application and other explanatory material, as discussed further in paragraph .09, and introductory material that provides context relevant to a proper understanding of the SQCSs and definitions.

.07 The objective provides the context in which the requirements of SQCSs are set and is intended to assist the firm in the following:

- Understanding what needs to be accomplished
- Deciding whether more needs to be done to achieve the objective

.08 SQCSs use two categories of professional requirements, identified by specific terms, to describe the degree of responsibility they impose on firms, as follows:

- *Unconditional requirements.* The firm is required to comply with an unconditional requirement in all cases in which such a requirement is relevant. SQCSs use the word *must* to indicate an unconditional requirement.
- *Presumptively mandatory requirements.* The firm is also required to comply with a presumptively mandatory requirement in all cases in which such a requirement is relevant; however, in rare circumstances, the firm may depart from a presumptively mandatory requirement, provided that the firm documents the justification for the departure and how the alternative policies established, or procedures performed, in the circumstances were sufficient to achieve the objectives of the presumptively mandatory requirement. SQCSs use the word *should* to indicate a presumptively mandatory requirement.

If an SQCS provides that a procedure or action is one that the firm "should consider," the consideration of the procedure or action is presumptively required, whereas carrying out the procedure or action is not. The professional requirements of an SQCS are to be understood and applied in the context of the explanatory material that provides guidance for their application.

.09 When necessary, the application and other explanatory material provides further explanation of the requirements and guidance for carrying them out. In particular, it may

- explain more precisely what a requirement means or is intended to cover.
- include examples of policies and procedures that may be appropriate in the circumstances.

The words *may*, *might*, and *could*, among others, are used to describe these actions and procedures. Although such guidance does not, in itself, impose a requirement, it is relevant to the proper application of the requirements. The application and other explanatory material may also provide background information on matters addressed in SQCSs. When appropriate, additional considerations specific to governmental entities or smaller firms are included within the application and other explanatory material. These additional considerations assist in the application of the requirements in SQCSs. They do not, however, limit or reduce the responsibility of the firm to apply and comply with the requirements in SQCSs.

.10 SQCSs include, under the heading "Definitions," a description of the meanings attributed to certain terms for purposes of the SQCSs. These are provided to assist in the consistent application and interpretation of SQCSs and are not intended to override definitions that may be established for other purposes, whether in law, regulation, or otherwise. The AU-C glossary contains a complete listing of terms defined in this section. It also includes descriptions of other terms found in this section to assist in common and consistent



interpretation. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

## Effective Date

.11 The provisions of this section are applicable to a CPA firm's system of quality control for its accounting and auditing practice as of January 1, 2012.

## Objective

.12 The objective of the firm is to establish and maintain a system of quality control to provide it with reasonable assurance that

- a. the firm and its personnel comply with professional standards and applicable legal and regulatory requirements and
- b. reports issued by the firm are appropriate in the circumstances.

## Definitions

.13 For purposes of SQCSs, the following terms have the meanings attributed as follows:

**Accounting and auditing practice.** A practice that performs engagements covered by this section, which are audit, attestation, compilation, review, and any other services for which standards have been promulgated by the AICPA Auditing Standards Board (ASB) or the AICPA Accounting and Review Services Committee (ARSC) under the "General Standards Rule" (ET sec. 1.300.001) or the "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct. Although standards for other engagements may be promulgated by other AICPA technical committees, engagements performed in accordance with those standards are not encompassed in the definition of an *accounting and auditing practice*.

**Engagement documentation.** The record of the work performed, results obtained, and conclusions that the practitioner reached (also known as *working papers* or *workpapers*).

**Engagement partner.** The partner or other person in the firm who is responsible for the engagement and its performance and for the report that is issued on behalf of the firm and who, when required, has the appropriate authority from a professional, legal, or regulatory body.

**Engagement quality control review.** A process designed to provide an objective evaluation, before the report is released, of the significant judgments the engagement team made and the conclusions it reached in formulating the report. The engagement quality control review process is only for those engagements, if any, for which the firm has determined that an engagement quality control review is required, in accordance with its policies and procedures.

**Engagement quality control reviewer.** A partner, other person in the firm, suitably qualified external person, or team made up of such individuals, none of whom is part of the engagement team, with sufficient and appropriate experience and authority to objectively evaluate the significant judgments that the engagement team made and the conclusions it reached in formulating the report.

**Engagement team.** All partners and staff performing the engagement and any individuals engaged by the firm or a network firm who

perform procedures on the engagement. This excludes external specialists engaged by the firm or a network firm.<sup>1</sup>

The term *engagement team* also excludes individuals within the client's internal audit function who provide direct assistance on an audit engagement when the external auditor complies with the requirements of section 610, *Using the Work of Internal Auditors*.

**Firm.** A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the AICPA and that is engaged in public practice.

**Inspection.** A retrospective evaluation of the adequacy of the firm's quality control policies and procedures, its personnel's understanding of those policies and procedures, and the extent of the firm's compliance with them. Inspection includes a review of completed engagements.

**Monitoring.** A process comprising an ongoing consideration and evaluation of the firm's system of quality control, including inspection or a periodic review of engagement documentation, reports, and clients' financial statements for a selection of completed engagements, designed to provide the firm with reasonable assurance that its system of quality control is designed appropriately and operating effectively.

**Network.** An association of entities, as defined in ET section 0.400, *Definitions*.

**Network firm.** A firm or other entity that belongs to a network, as defined in ET section 0.400.

**Partner.** Any individual with authority to bind the firm with respect to the performance of a professional services engagement. For purposes of this definition, *partner* may include an employee with this authority who has not assumed the risks and benefits of ownership. Firms may use different titles to refer to individuals with this authority.

**Personnel.** Partners and staff.

**Professional standards.** Standards promulgated by the ASB or ARSC under the "General Standards Rule" or the "Compliance With Standards Rule" of the AICPA Code of Professional Conduct, or other standards-setting bodies that set auditing and attest standards applicable to the engagement being performed and relevant ethical requirements.

**Reasonable assurance.** In the context of this section, a high, but not absolute, level of assurance.

**Relevant ethical requirements.** Ethical requirements to which the firm and its personnel are subject, which consist of the AICPA Code of Professional Conduct together with rules of applicable state boards of accountancy and applicable regulatory agencies that are more restrictive.

**Staff.** Professionals, other than partners, including any specialists that the firm employs.

**Suitably qualified external person.** An individual outside the firm with the competence and capabilities to act as an engagement partner (for example, a partner of another firm).

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<sup>1</sup> Paragraph .06 of AU-C section 620, *Using the Work of an Auditor's Specialist*, defines the term *auditor's specialist*. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

## Requirements

### Applying and Complying With Relevant Requirements

**.14** Personnel within the firm responsible for establishing and maintaining the firm's system of quality control should have an understanding of the entire text of this section, including its application and other explanatory material, to understand its objective and apply its requirements properly.

**.15** The firm should comply with each requirement of this section unless, in the circumstances of the firm, the requirement is not relevant to the services provided by a firm's accounting and auditing practice. (Ref: par. .A1)

**.16** The requirements are designed to enable the firm to achieve the objective stated in this section. The proper application of the requirements is, therefore, expected to provide a sufficient basis for the achievement of the objective. However, because circumstances vary widely and all such circumstances cannot be anticipated, the firm should consider whether there are particular matters or circumstances that require the firm to establish policies and procedures in addition to those required by this section to meet the stated objective.

### Elements of a System of Quality Control

**.17** The firm must establish and maintain a system of quality control. The system of quality control should include policies and procedures addressing each of the following elements:

- a.* Leadership responsibilities for quality within the firm (the tone at the top)
- b.* Relevant ethical requirements
- c.* Acceptance and continuance of client relationships and specific engagements
- d.* Human resources
- e.* Engagement performance
- f.* Monitoring

Policies and procedures established by the firm related to each element are designed to achieve reasonable assurance with respect to the purpose of that element. Deficiencies in policies and procedures for an element may result in not achieving reasonable assurance with respect to the purpose of that element; however, the system of quality control as a whole may still be effective in achieving the objective described in paragraph .12.

**.18** The firm should document its policies and procedures and communicate them to the firm's personnel. (Ref: par. .A2–.A3)

### Leadership Responsibilities for Quality Within the Firm

**.19** The firm should establish policies and procedures designed to promote an internal culture based on the recognition that quality is essential in performing engagements. Such policies and procedures should require the firm's

leadership (managing partner or board of managing partners, CEO, or equivalent) to assume ultimate responsibility for the firm's system of quality control. (Ref: par. .A4–.A5)

**.20** The firm should establish policies and procedures designed to provide it with reasonable assurance that any person or persons assigned operational responsibility for the firm's system of quality control by the firm's leadership has sufficient and appropriate experience and ability, and the necessary authority, to assume that responsibility. (Ref: par. .A6)

## Relevant Ethical Requirements

**.21** The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements. (Ref: par. .A7–.A9)

### *Independence*

**.22** The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm; its personnel; and, when applicable, others subject to independence requirements (including network firm personnel) maintain independence when required by relevant ethical requirements. Such policies and procedures should enable the firm to

- a. communicate its independence requirements to its personnel and, when applicable, others subject to them and
- b. identify and evaluate circumstances and relationships that create threats to independence and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards or, if considered appropriate, to withdraw from the engagement when withdrawal is possible under applicable law or regulation.

**.23** Such policies and procedures should require

- a. engagement partners to provide the firm with relevant information about client engagements, including the scope of services, to enable the firm to evaluate the overall effect, if any, on independence requirements;
- b. personnel to promptly notify the firm of circumstances and relationships that create a threat to independence so that appropriate action can be taken; and
- c. the accumulation and communication of relevant information to appropriate personnel so that
  - i. the firm and its personnel can readily determine whether they satisfy independence requirements,
  - ii. the firm can maintain and update information relating to independence, and
  - iii. the firm can take appropriate action regarding identified threats to independence that are not at an acceptable level.

**.24** The firm should establish policies and procedures designed to provide it with reasonable assurance that it is notified of breaches of independence requirements and to enable it to take appropriate actions to resolve such situations. The policies and procedures should include requirements for

- a. personnel to promptly notify the firm of independence breaches of which they become aware;

- b. the firm to promptly communicate identified breaches of these policies and procedures to
  - i. the engagement partner who, with the firm, needs to address the breach and
  - ii. other relevant personnel in the firm and, when appropriate, the network and those subject to the independence requirements who need to take appropriate action; and
- c. prompt communication to the firm, if necessary, by the engagement partner and the other individuals referred to in subparagraph (b)(ii) of the actions taken to resolve the matter so that the firm can determine whether it should take further action.

**.25** At least annually, the firm should obtain written confirmation of compliance with its policies and procedures on independence from all firm personnel required to be independent by the requirements set forth in the "Independence Rule" (ET sec. 1.200.001) and related interpretations of the AICPA Code of Professional Conduct and the rules of state boards of accountancy and applicable regulatory agencies. (Ref: par. .A10) [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

**.26** The firm should establish policies and procedures for all audit or attestation engagements for which regulatory or other authorities require the rotation of personnel after a specified period, in compliance with such requirements.

## Acceptance and Continuance of Client Relationships and Specific Engagements

**.27** The firm should establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide the firm with reasonable assurance that it will undertake or continue relationships and engagements only when the firm

- a. is competent to perform the engagement and has the capabilities, including time and resources, to do so; (Ref: par. .A11)
- b. can comply with legal and relevant ethical requirements; and
- c. has considered the integrity of the client and does not have information that would lead it to conclude that the client lacks integrity. (Ref: par. .A12–.A13)

**.28** Such policies and procedures should

- a. require the firm to obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. (Ref: par. .A14)
- b. require the firm to determine whether it is appropriate to accept the engagement if a potential conflict of interest is identified in accepting an engagement from a new or an existing client.
- c. if issues have been identified and the firm decides to accept or continue the client relationship or a specific engagement, require the firm to
  - i. consider whether ethical requirements that exist under the "Conflicts of Interest" interpretation (ET sec.

1.110.010) under the "Integrity and Objectivity Rule" (ET sec. 1.100.001) apply, and

- ii. document how the issues were resolved.

[Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

**.29** To minimize the risk of misunderstandings regarding the nature, scope, and limitations of the services to be performed, the firm should establish policies and procedures that provide for obtaining an understanding with the client regarding those services. (Ref: par. .A15)

**.30** The firm should establish policies and procedures on continuing an engagement and the client relationship that address the circumstances when the firm obtains information that would have caused it to decline the engagement had that information been available earlier. Such policies and procedures should include consideration of the following:

- a. The professional and legal responsibilities that apply to the circumstances, including whether there is a requirement for the firm to report to regulatory authorities
- b. The possibility of withdrawing from the engagement or from both the engagement and the client relationship (Ref: par. .A16)

## Human Resources

**.31** The firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the competence, capabilities, and commitment to ethical principles necessary to

- a. perform engagements in accordance with professional standards and applicable legal and regulatory requirements and
- b. enable the firm to issue reports that are appropriate in the circumstances. (Ref: par. .A17–.A24)

**.32** The firm's policies and procedures should provide that personnel selected for advancement have the qualifications necessary for fulfillment of the responsibilities that they will be called on to assume.

## Assignment of Engagement Teams

**.33** The firm should assign responsibility for each engagement to an engagement partner and should establish policies and procedures requiring that

- a. the identity and role of the engagement partner are communicated to management and those charged with governance;
- b. the engagement partner has the appropriate competence, capabilities, and authority to perform the role; and (Ref: par. .A25–.A30)
- c. the responsibilities of the engagement partner are clearly defined and communicated to that individual.

**.34** The firm should establish policies and procedures to assign appropriate personnel with the necessary competence and capabilities to

- a. perform engagements in accordance with professional standards and applicable legal and regulatory requirements and
- b. enable the firm to issue reports that are appropriate in the circumstances. (Ref: par. .A31)

## Engagement Performance

**.35** The firm should establish policies and procedures designed to provide it with reasonable assurance that engagements are performed in accordance with professional standards and applicable legal and regulatory requirements and that the firm issues reports that are appropriate in the circumstances. Such policies and procedures should include the following:

- a. Matters relevant to promoting consistency in the quality of engagement performance (Ref: par. .A32–.A33)
- b. Supervision responsibilities (Ref: par. .A34)
- c. Review responsibilities (Ref: par. .A35)

**.36** The firm's review responsibility policies and procedures should be determined on the basis that suitably experienced engagement team members, which may include the engagement partner, review work performed by other engagement team members.

## Consultation

**.37** The firm should establish policies and procedures designed to provide it with reasonable assurance that

- a. appropriate consultation takes place on difficult or contentious issues;
- b. sufficient resources are available to enable appropriate consultation to take place;
- c. the nature and scope of such consultations are documented and are agreed upon by both the individual seeking consultation and the individual consulted; and
- d. the conclusions resulting from consultations are documented, understood by both the individual seeking consultation and the individual consulted, and implemented. (Ref: par. .A36–.A40)

## Engagement Quality Control Review

**.38** The firm should establish criteria against which all engagements covered by this section should be evaluated to determine whether an engagement quality control review should be performed. (Ref: par. .A41)

**.39** The firm's policies and procedures should require that if an engagement meets the criteria established, an engagement quality control review should be performed for that engagement.

**.40** The firm should establish policies and procedures setting out the nature, timing, and extent of an engagement quality control review. Such policies and procedures should require that the engagement quality control review be completed before the report is released. (Ref: par. .A42–.A44)

**.41** The firm should establish policies and procedures to require the engagement quality control review to include

- a. discussion of significant findings and issues with the engagement partner;
- b. reading the financial statements or other subject matter information and the proposed report;
- c. review of selected engagement documentation relating to significant judgments that the engagement team made and the related conclusions it reached; and

- d. evaluation of the conclusions reached in formulating the report and consideration of whether the proposed report is appropriate. (Ref: par. .A45–.A47)

*Criteria for the Eligibility of Engagement Quality Control Reviewers*

**.42** The firm should establish policies and procedures to address the appointment of engagement quality control reviewers and to establish their eligibility through

- a. the technical qualifications required to perform the role, including the necessary experience and authority, and (Ref: par. .A48)
- b. the degree to which an engagement quality control reviewer can be consulted on the engagement without compromising the reviewer's objectivity. (Ref: par. .A49)

**.43** The firm should establish policies and procedures designed to maintain the objectivity of the engagement quality control reviewer. Such policies and procedures should provide that although the engagement quality control reviewer is not a member of the engagement team, the engagement quality control reviewer should satisfy the independence requirements relating to the engagements reviewed. Accordingly, such policies and procedures should provide that the engagement quality control reviewer

- a. when practicable, is not selected by the engagement partner.
- b. does not otherwise participate in the performance of the engagement during the period of review.
- c. does not make decisions for the engagement team.
- d. is not subject to other considerations that would threaten the reviewer's objectivity.

**.44** The firm's policies and procedures should provide for the replacement of the engagement quality control reviewer when the reviewer's ability to perform an objective review is likely to have been impaired. (Ref: par. .A50)

*Documentation of the Engagement Quality Control Review*

**.45** The firm should establish policies and procedures on documentation of the engagement quality control review, which require documentation that

- a. the procedures required by the firm's policies on engagement quality control review have been performed;
- b. the engagement quality control review has been completed before the report is released; and
- c. the reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments that the engagement team made and the conclusions it reached were not appropriate.

***Differences of Opinion***

**.46** The firm should establish policies and procedures for addressing and resolving differences of opinion within the engagement team; with those consulted; and, when applicable, between the engagement partner and the engagement quality control reviewer. (Ref: par. .A51–.A52)

**.47** Such policies and procedures should enable a member of the engagement team to document that member's disagreement with the conclusions reached after appropriate consultation.



- .48** Such policies and procedures should require the following:
- a. Conclusions reached be documented and implemented
  - b. The report not be released until the matter is resolved

### **Engagement Documentation**

#### *Completion of the Assembly of Final Engagement Files*

**.49** The firm should establish policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis after the engagement reports have been released. (Ref: par. .A53–.A54)

#### *Confidentiality, Safe Custody, Integrity, Accessibility, and Retrievability of Engagement Documentation*

**.50** The firm should establish policies and procedures designed to maintain the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation. (Ref: par. .A55–.A58)

#### *Retention of Engagement Documentation*

**.51** The firm should establish policies and procedures for the retention of engagement documentation for a period sufficient to meet the needs of the firm, professional standards, laws, and regulations. (Ref: par. .A59–.A62)

## **Monitoring**

### **Monitoring the Firm's Quality Control Policies and Procedures**

**.52** The firm should establish a monitoring process designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively. This process should

- a. include an ongoing consideration and evaluation of the firm's system of quality control, including inspection or a periodic review of engagement documentation, reports, and clients' financial statements for a selection of completed engagements;
- b. require responsibility for the monitoring process to be assigned to a partner or partners or other persons with sufficient and appropriate experience and authority in the firm to assume that responsibility; and
- c. assign the performance of monitoring the firm's system of quality control to qualified individuals. (Ref: par. .A63–.A73)

### **Evaluating, Communicating, and Remediating Identified Deficiencies**

**.53** Any system of quality control has inherent limitations that can reduce its effectiveness. Deficiencies in individual engagements covered by this section do not, in and of themselves, indicate that the firm's system of quality control is insufficient to provide it with reasonable assurance that its personnel comply with applicable professional standards.

**.54** The firm should evaluate the effect of deficiencies noted as a result of the monitoring process and determine whether they are either

- a. instances that do not necessarily indicate that the firm's system of quality control is insufficient to provide it with reasonable assurance that it complies with professional standards and applicable legal and regulatory requirements and that the reports issued by the firm are appropriate in the circumstances or

- b. systemic, repetitive, or other significant deficiencies that require prompt corrective action.

**.55** The firm should communicate to relevant engagement partners, and other appropriate personnel, deficiencies noted as a result of the monitoring process and recommendations for appropriate remedial action. (Ref: par. .A74)

**.56** Recommendations for appropriate remedial actions for deficiencies noted should include one or more of the following:

- a. Taking appropriate remedial action in relation to an individual engagement or member of personnel
- b. The communication of the findings to those responsible for training and professional development
- c. Changes to the quality control policies and procedures
- d. Disciplinary action against those who fail to comply with the policies and procedures of the firm, especially those who do so repeatedly

**.57** The firm should establish policies and procedures to address cases when the results of the monitoring procedures indicate that a report may be inappropriate or that procedures were omitted during the performance of the engagement. Such policies and procedures should require the firm to

- a. determine what further action is appropriate to comply with relevant professional standards and legal and regulatory requirements and
- b. consider whether to obtain legal advice.

**.58** The firm should communicate, at least annually, the results of the monitoring of its system of quality control to engagement partners and other appropriate individuals within the firm, including the firm's leadership. This communication should be sufficient to enable the firm and these individuals to take prompt and appropriate action, when necessary, in accordance with their defined roles and responsibilities to provide a basis for them to rely on the firm's system of quality control. Information communicated should include the following:

- a. A description of the monitoring procedures performed
- b. The conclusions drawn from the monitoring procedures
- c. When relevant, a description of systemic, repetitive, or other significant deficiencies and of the actions taken to resolve or amend those deficiencies

**.59** Some firms operate as part of a network and, for consistency, may implement some of their monitoring procedures on a network basis. When firms within a network operate under common monitoring policies and procedures designed to comply with this section, and these firms place reliance on such a monitoring system, the firm's policies and procedures should require that

- a. at least annually, the network communicate the overall scope, extent, and results of the monitoring process to appropriate individuals within the network firms and
- b. the network communicate promptly any identified deficiencies in the quality control system to appropriate individuals within the relevant network firm or firms so that the necessary action can be taken in order that engagement partners in the network firms can rely on the results of the monitoring process implemented within the network, unless the firms or the network advise otherwise.

### **Complaints and Allegations**

**.60** The firm should establish policies and procedures designed to provide it with reasonable assurance that it deals appropriately with

- a. complaints and allegations that the work performed by the firm fails to comply with professional standards and applicable legal and regulatory requirements and
- b. allegations of noncompliance with the firm's system of quality control.

As part of this process, the firm should establish clearly defined channels for firm personnel to raise any concerns in a manner that enables them to come forward without fear of reprisals. (Ref: par. .A75)

**.61** If, during the investigations into complaints and allegations, deficiencies in the design or operation of the firm's quality control policies and procedures, or instances of noncompliance with the firm's system of quality control by an individual or individuals are identified, the firm should take appropriate actions, as set out in paragraph .56. (Ref: par. .A76–.A77)

### **Documentation of the System of Quality Control**

**.62** The firm should establish policies and procedures requiring appropriate documentation to provide evidence of the operation of each element of its system of quality control. (Ref: par. .A78–.A80)

**.63** The firm should establish policies and procedures that require retention of documentation for a period of time sufficient to permit those performing monitoring procedures and peer review of the firm to evaluate the firm's compliance with its system of quality control or for a longer period if required by law or regulation.<sup>2</sup>

**.64** The firm should establish policies and procedures requiring documentation of complaints and allegations described in paragraph .60 and the responses to them.

## **Application and Other Explanatory Material**

### **Applying and Complying With Relevant Requirements**

#### ***Considerations Specific to Smaller Firms (Ref: par. .15)***

**.A1** This section does not call for compliance with requirements that are not relevant (for example, in the circumstances of a sole practitioner with no staff). Requirements in this section, such as those for policies and procedures for the assignment of appropriate personnel to the engagement team (see paragraph .34), for review responsibilities (see paragraph .36), and for the annual communication of the results of monitoring to engagement partners within the firm (see paragraph .58) are not relevant in the absence of staff.

### **Elements of a System of Quality Control (Ref: par. .18)**

**.A2** In general, communication of quality control policies and procedures to firm personnel includes a description of the quality control policies and procedures and the objectives they are designed to achieve and the message that each

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<sup>2</sup> PR section 100, *Standards for Performing and Reporting on Peer Reviews*, is applicable to firms enrolled in the AICPA Peer Review Program.

individual has a personal responsibility for quality and is expected to comply with these policies and procedures. By encouraging firm personnel to communicate their views or concerns on quality control matters, the firm recognizes the importance of obtaining feedback on the firm's system of quality control. Although communication is enhanced if it is in writing, the communication of quality control policies and procedures is not required to be in writing.

### ***Considerations Specific to Smaller Firms***

**.A3** Documentation and communication of policies and procedures for smaller firms may be less formal and extensive than for larger firms.

## **Leadership Responsibilities for Quality Within the Firm**

### ***Promoting an Internal Culture of Quality (Ref: par. .19)***

**.A4** The firm's leadership, and the examples it sets, significantly influences the internal culture of the firm. The promotion of a quality-oriented internal culture depends on clear, consistent, and frequent actions and messages from all levels of the firm's management that emphasize the firm's quality control policies and procedures and the requirement to

- a. perform work that complies with professional standards and applicable legal and regulatory requirements.
- b. issue reports that are appropriate in the circumstances.

Such actions and messages encourage a culture that recognizes and rewards quality work. These actions and messages may be communicated by, but are not limited to, training seminars, meetings, formal or informal dialogue, mission statements, newsletters, or briefing memoranda. They may be incorporated in partner and staff appraisal procedures and the firm's internal documentation and training materials, such that they will support and reinforce the firm's view on the importance of quality and how, practically, it is to be achieved.

**.A5** Of particular importance in promoting an internal culture based on quality is the need for the firm's leadership to recognize that the firm's business strategy is subject to the overarching requirement for the firm to achieve the objectives of the system of quality control in all the engagements that the firm performs. Promoting such an internal culture includes the following:

- a. Establishment of policies and procedures that address performance evaluation, compensation, and advancement (including incentive systems) with regard to its personnel in order to demonstrate the firm's overarching commitment to quality
- b. Assignment of management responsibilities so that commercial considerations do not override the quality of the work performed
- c. Provision of sufficient and appropriate resources for the development, documentation, and support of its quality control policies and procedures

### ***Assigning Operational Responsibility for the Firm's System of Quality Control (Ref: par. .20)***

**.A6** Sufficient and appropriate experience and ability enables the person or persons responsible for the firm's system of quality control to identify and understand quality control issues and to develop appropriate policies and procedures. Necessary authority enables the person or persons to implement those policies and procedures.

## Relevant Ethical Requirements

### ***Compliance With Relevant Ethical Requirements (Ref: par. .21)***

.A7 The AICPA Code of Professional Conduct establishes the fundamental principles of professional ethics, which include the following:

- Responsibilities
- The public interest
- Integrity
- Objectivity and independence
- Due care
- Scope and nature of services

.A8 Independence requirements are set forth in the "Independence Rule" and related interpretations of the AICPA Code of Professional Conduct and the rules of state boards of accountancy and applicable regulatory agencies. Guidance on threats to independence and safeguards to mitigate such threats involving matters that are not explicitly addressed in the Code of Professional Conduct are set forth in the "Conceptual Framework for Independence" (ET sec. 1.210.010). [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

.A9 The fundamental principles are reinforced, in particular, by the following:

- The leadership of the firm
- Education and training
- Monitoring
- A process for dealing with noncompliance

*Written Confirmation (Ref: par. .25)*

.A10 Written confirmation may be in paper or electronic form. By obtaining confirmation and taking appropriate action on information indicating non-compliance, the firm demonstrates the importance that it attaches to independence and keeps the issue current for, and visible to, its personnel.

## Acceptance and Continuance of Client Relationships and Specific Engagements

### ***Competence, Capabilities, and Resources (Ref: par. .27a)***

.A11 Consideration of whether the firm has the competence, capabilities, and resources to undertake a new engagement from a new or an existing client involves reviewing the specific requirements of the engagement and the existing partner and staff profiles at all relevant levels, including whether

- firm personnel have knowledge of relevant industries or subject matters or the ability to effectively gain the necessary knowledge;
- firm personnel have experience with relevant regulatory or reporting requirements or the ability to effectively gain the necessary competencies;
- the firm has sufficient personnel with the necessary competence and capabilities;
- specialists are available, if needed;

- individuals meeting the criteria and eligibility requirements to perform an engagement quality control review are available, when applicable; and
- the firm is able to complete the engagement within the reporting deadline.

### ***Integrity of a Client (Ref: par. .27c)***

.A12 Matters to consider regarding the integrity of a client include, for example, the following:

- The identity and business reputation of the client's principal owners, key management, and those charged with governance
- The nature of the client's operations, including its business practices
- Information concerning the attitude of the client's principal owners, key management, and those charged with governance toward such matters as internal control or aggressive interpretation of accounting standards
- Indications of an inappropriate limitation in the scope of the work
- Indications that the client might be involved in money laundering or other criminal activities
- The reasons for the proposed appointment of the firm and non-reappointment of the previous firm

The extent of knowledge that a firm will have regarding the integrity of a client will generally grow within the context of an ongoing relationship with that client.

.A13 Sources of information on such matters obtained by the firm may include the following:

- Communications with existing or previous providers of professional accountancy services to the client, in accordance with relevant ethical requirements, and discussions with other third parties
- Inquiry of other firm personnel or third parties, such as bankers, legal counsel, and industry peers
- Background searches of relevant databases

### ***Continuance of a Client Relationship (Ref: par. .28a)***

.A14 Deciding whether to continue a client relationship includes consideration of significant issues that have arisen during the current or previous engagements and their implications for continuing the relationship. For example, a client may have started to expand its business operations into an area where the firm does not possess, and cannot obtain, the necessary expertise.

### ***Obtaining an Understanding With the Client (Ref: par. .29)***

.A15 Professional standards applicable to the engagement may contain requirements for obtaining a written understanding with the client.

### ***Withdrawal (Ref: par. .30)***

.A16 Policies and procedures on withdrawal from an engagement or from both the engagement and the client relationship may address issues that include the following:

- Discussing with the appropriate level of the client's management and those charged with governance the appropriate action that the firm might take based on the relevant facts and circumstances
- If the firm determines that it is appropriate to withdraw, discussing with the appropriate level of the client's management and those charged with governance withdrawal from the engagement or from both the engagement and the client relationship and the reasons for the withdrawal
- Considering whether there is a professional, legal, or regulatory requirement for the firm to remain in place or for the firm to report the withdrawal from the engagement or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities
- Documenting significant matters, consultations, conclusions, and the basis for the conclusions

### Human Resources (Ref: par. .31)

.A17 Personnel issues relevant to the firm's policies and procedures related to human resources include, for example, the following:

- Recruitment and hiring, if applicable
- Performance evaluation, compensation, and advancement
- Determining competencies and capabilities, including time to perform assignments
- Professional development
- The estimation of personnel needs

Effective recruitment processes and procedures help the firm select individuals of integrity who have the capacity to develop the competence and capabilities necessary to perform the firm's work and possess the appropriate characteristics to enable them to perform competently. Examples of such characteristics may include meeting minimum academic requirements established by the firm, maturity, integrity, and leadership traits.

.A18 *Competencies and capabilities* are the knowledge, skills, and abilities that qualify personnel to perform an engagement covered by this section. Competencies and capabilities are not measured by periods of time because such a quantitative measurement may not accurately reflect the kinds of experiences gained by personnel in any given time period. Accordingly, for purposes of this section, a measure of overall competency is qualitative rather than quantitative.

.A19 Competence can be developed through a variety of methods; these methods include, for example, the following:

- Professional education
- Continuing professional development, including training
- Work experience
- Mentoring by more experienced staff, such as other members of the engagement team
- Independence education for personnel who are required to be independent

**.A20** The continuing competence of the firm's personnel depends, to a significant extent, on an appropriate level of continuing professional development so that personnel maintain their knowledge and capabilities. Effective policies and procedures emphasize the need for all levels of firm personnel to participate in general and industry-specific continuing professional education (CPE) and other professional development activities that enable them to fulfill responsibilities assigned and to satisfy applicable CPE requirements of the AICPA and regulatory agencies. Effective policies and procedures also place importance on passing the Uniform CPA Examination. The firm may provide the necessary training resources and assistance to enable personnel to develop and maintain the required competence and capabilities.

**.A21** The firm may use a suitably qualified external person, for example, when internal technical and training resources are unavailable.

**.A22** Effective performance evaluation, compensation, and advancement procedures give due recognition and reward to the development and maintenance of competence and commitment to ethical principles. Steps that a firm may take in developing and maintaining competence and commitment to ethical principles include the following:

- Making personnel aware of the firm's expectations regarding performance and ethical principles
- Providing personnel with an evaluation of, and counseling on, performance, progress, and career development
- Helping personnel understand that their compensation and advancement to positions of greater responsibility depend upon, among other things, performance quality and adherence to ethical principles and that failure to comply with the firm's policies and procedures may result in disciplinary action.

### ***Considerations Specific to Smaller Firms***

**.A23** The size and circumstances of the firm are important considerations in determining the structure of the firm's performance evaluation process. Smaller firms, in particular, may employ less formal methods of evaluating the performance of their personnel.

### ***The Relationship of the Competency Requirement of the Uniform Accountancy Act to the Human Resource Element of Quality Control***

**.A24** CPAs are required to follow the accountancy laws of the individual licensing jurisdictions in the United States that govern public practice. These jurisdictions may have adopted, in whole or in part, the Uniform Accountancy Act (UAA), which is a model legislative statute, including related administrative rules, designed by the AICPA and the National Association of State Boards of Accountancy to provide a uniform approach to the regulation of the accounting profession. The UAA provides that "[a]ny individual licensee ... who is responsible for supervising attest or compilation services and signs or authorizes someone to sign the accountant's report on the financial statements on behalf of the firm, shall meet the competency requirements set out in the professional standards for such services." A firm's compliance with this section is intended to enable a practitioner who performs accounting and auditing services on the firm's behalf to meet the competency requirement referred to in the UAA. [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]



**Assignment of Engagement Teams**

*Engagement Partners (Ref: par. .33)*

**.A25** In most cases, an engagement partner will have gained the necessary competencies through relevant and appropriate experience in engagements covered by this section. In some cases, however, an engagement partner may have obtained the necessary competencies through disciplines other than public practice, such as in relevant industry, governmental, and academic positions. When necessary, the experience of the engagement partner may be supplemented by CPE and consultation. The following are examples:

- An engagement partner whose recent experience has consisted primarily in providing tax services may acquire the competencies necessary in the circumstances to perform a compilation or review engagement by obtaining relevant CPE.
- An engagement partner whose experience consists of performing review and compilation engagements may be able to obtain the necessary competencies to perform an audit by becoming familiar with the industry in which the client operates, obtaining CPE relating to auditing, using consulting sources during the course of performing the audit engagement, or any combination of these.
- A person in academia might obtain the necessary competencies to perform engagements covered by this section by (a) obtaining specialized knowledge through teaching or authorship of research projects or similar papers and (b) performing a rigorous self-study program or by engaging a consultant to assist on such engagements.

[Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

**.A26** The characteristics of a particular client, industry, and the kind of service being provided determine the nature and extent of competencies established by a firm that are expected of the engagement partner. For example

- the competencies expected of an engagement partner to compile financial statements would be different than those expected of a practitioner engaged to review or audit financial statements.
- supervising engagements and signing or authorizing others to sign reports for clients in certain industries or engagements, such as financial services, governmental, or employee benefit plan engagements, would require different competencies than those expected in performing attest services for clients in other industries.
- the engagement partner for an attestation engagement to examine the effectiveness of an entity's internal control over financial reporting that is integrated with an audit of financial statements would be expected to have technical proficiency in understanding and evaluating the effectiveness of controls, whereas an engagement partner of an attestation engagement to examine investment performance statistics would be expected to have different competencies, including an understanding of the subject matter of the underlying assertion.

**.A27** In practice, the competencies necessary for the engagement partner are broad and varied in both their nature and number. Competencies include the following, as well as other competencies as necessary in the circumstances:

- *Understanding of the role of a system of quality control and the Code of Professional Conduct.* An understanding of the role of a firm's system of quality control and the AICPA's Code of Professional Conduct, both of which play critical roles in assuring the integrity of the various kinds of reports.
- *Understanding of the service to be performed.* An understanding of the performance, supervision, and reporting aspects of the engagement. This understanding is usually gained through actual participation under appropriate supervision in that type of engagement.
- *Technical proficiency.* An understanding of the applicable professional standards, including those standards directly related to the industry in which a client operates, and the kinds of transactions in which a client engages.
- *Familiarity with the industry.* An understanding of the industry in which a client operates to the extent required by professional standards applicable to the kind of service being performed. In performing an audit or review of financial statements, this understanding would include an industry's organization and operating characteristics sufficient to identify areas of high or unusual risk associated with an engagement and to evaluate the reasonableness of industry-specific estimates.
- *Professional judgment.* Skills that indicate sound professional judgment. In performing engagements covered by this section, such skills would typically include the ability to exercise professional skepticism and identify areas requiring special consideration, including, for example, the evaluation of the reasonableness of estimates and representations made by management and the determination of the kind of report appropriate in the circumstances.
- *Understanding the organization's IT systems.* A sufficient understanding of how the organization is dependent on, or enabled by, information technologies and the manner in which the information systems are used to record and maintain financial information to determine when involvement of an IT professional is necessary for an audit engagement.

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

**.A28** The competencies previously listed are interrelated and gaining one particular competency may be related to achieving another. For example, familiarity with the client's industry interrelates with a practitioner's ability to make professional judgments relating to the client.

**.A29** In establishing policies and procedures related to the nature of competencies needed by the engagement partner of an engagement, a firm may consider the requirements of policies and procedures established for other elements of quality control. For example, a firm might consider its requirements related to engagement performance in determining the nature of competency requirements that describe the degree of technical proficiency necessary in a given set of circumstances.

**.A30** Policies and procedures may include systems to monitor the workload and availability of engagement partners so as to enable these individuals to have sufficient time to adequately discharge their responsibilities.

*Engagement Teams (Ref: par. .34)*

**.A31** The firm's assignment of engagement teams and the determination of the level of supervision required include, for example, consideration of the engagement team's

- understanding of, and practical experience with, engagements of a similar nature and complexity through appropriate training and participation;
- understanding of professional standards and legal and regulatory requirements;
- technical knowledge and expertise, including knowledge of relevant IT;
- knowledge of relevant industries in which the clients operate;
- ability to apply professional judgment; and
- understanding of the firm's quality control policies and procedures.

Generally, as the ability and experience levels of assigned staff increase, the need for direct supervision decreases.

## Engagement Performance

*Consistency in the Quality of Engagement Performance (Ref: par. .35a)*

**.A32** The firm promotes consistency in the quality of engagement performance through its policies and procedures. This is often accomplished through written or electronic manuals, software tools or other forms of standardized documentation, and industry or subject matter-specific guidance materials. Matters addressed may include the following:

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

**.A33** Appropriate teamwork and training assist less experienced members of the engagement team to clearly understand the objectives of the assigned work.

*Supervision (Ref: par. .35b)*

**.A34** Engagement supervision includes the following:

- Tracking the progress of the engagement
- Considering the competence and capabilities of individual members of the engagement team, whether they have sufficient time to carry out their work, whether they understand their instructions, and whether the work is being carried out in accordance with the planned approach to the engagement

- Addressing significant findings and issues arising during the engagement, considering their significance, and modifying the planned approach appropriately
- Identifying matters for consultation or consideration by more experienced engagement team members during the engagement

**Review (Ref: par. .35c)**

**.A35** A review consists of consideration of whether

- the work has been performed in accordance with professional standards and applicable legal and regulatory requirements;
- significant findings and issues have been raised for further consideration;
- appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
- the nature, timing, and extent of the work performed is appropriate and without need for revision;
- the work performed supports the conclusions reached and is appropriately documented;
- the evidence obtained is sufficient and appropriate to support the report; and
- the objectives of the engagement procedures have been achieved.

**Consultation (Ref: par. .37)**

**.A36** Consultation includes discussion at the appropriate professional level with individuals within or outside the firm who have relevant specialized expertise.

**.A37** Consultation uses appropriate research resources, as well as the collective experience and technical expertise of the firm. Consultation helps promote quality and improves the application of professional judgment. Appropriate recognition of consultation in the firm's policies and procedures helps promote a culture in which consultation is recognized as a strength and personnel are encouraged to consult on difficult or contentious issues.

**.A38** Effective consultation on significant technical, ethical, and other matters within the firm or, when applicable, outside the firm can be achieved when those consulted

- are given all the relevant facts that will enable them to provide informed advice and
- have appropriate knowledge, authority, and experience

and when conclusions resulting from consultations are appropriately documented and implemented.

**.A39** Documentation that is sufficiently complete and detailed of consultations with other professionals that involve difficult or contentious matters contributes to an understanding of

- the issue on which consultation was sought and
- the results of the consultation, including any decisions made, the basis for those decisions, and how they were implemented.

**Considerations Specific to Smaller Firms**

.A40 A firm needing to consult externally may take advantage of advisory services provided by the following:

- Other firms
- Professional and regulatory bodies
- Commercial organizations that provide relevant quality control services

Before contracting for such services, consideration of the competence and capabilities of the external provider helps the firm determine whether the external provider is suitably qualified for that purpose.

**Engagement Quality Control Review**

*Criteria for an Engagement Quality Control Review (Ref: par. .38)*

.A41 The structure and nature of the firm's practice are important considerations in establishing criteria for determining which engagements are to be subject to an engagement quality control review. Such criteria may include, for example, the following:

- The nature of the engagement, including the extent to which it involves a matter of public interest
- The identification of unusual circumstances or risks in an engagement or class of engagements
- Whether laws or regulations require an engagement quality control review

*Nature, Timing, and Extent of the Engagement Quality Control Review (Ref: par. .40-.41)*

.A42 An engagement quality control review may include consideration of the following:

- The engagement team's evaluation of the firm's independence in relation to the specific engagement
- Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters and the conclusions arising from those consultations
- Whether documentation selected for review reflects the work performed in relation to the significant judgments and supports the conclusions reached

.A43 If the engagement quality control review is completed after the report is dated and identifies instances where additional procedures are needed or additional evidence is required, the date of the report is changed to the date when the additional procedures have been satisfactorily completed or the additional evidence has been obtained, in accordance with the professional standards applicable to the engagement.

.A44 Conducting the engagement quality control review in a timely manner at appropriate stages during the engagement allows significant issues to be promptly resolved to the engagement quality control reviewer's satisfaction before the report is released.

.A45 The extent of the engagement quality control review may depend upon, among other things, the complexity of the engagement and the risk that the report might not be appropriate in the circumstances. The performance of

an engagement quality control review does not reduce the responsibilities of the engagement partner.

**.A46** Other matters relevant to evaluating the significant judgments made by the engagement team that may be considered in an engagement quality control review for audits, as well as reviews of financial statements and other assurance and related services engagements, include the following:

- Significant risks identified during the engagement and the responses to those risks
- Judgments made, particularly with respect to materiality and significant risks
- The significance and disposition of corrected and uncorrected misstatements identified during the engagement
- The matters to be communicated to management and those charged with governance and, when applicable, other parties, such as regulatory bodies

**.A47** When the engagement quality control reviewer makes recommendations that the engagement partner does not accept and the matter is not resolved to the reviewer's satisfaction, the firm's procedures for dealing with differences of opinion apply.

#### *Criteria for the Eligibility of Engagement Quality Control Reviewers*

Sufficient and Appropriate Technical Expertise, Experience, and Authority (Ref: par. .42a)

**.A48** What constitutes sufficient and appropriate technical expertise, experience, and authority depends on the circumstances of the engagement.

Consultation With the Engagement Quality Control Reviewer (Ref: par. .42b)

**.A49** The engagement partner may consult the engagement quality control reviewer at any stage during the engagement (for example, to establish that a judgment made by the engagement partner will be acceptable to the engagement quality control reviewer). Such consultation avoids identification of differences of opinion at a late stage of the engagement and does not necessarily impair the engagement quality control reviewer's eligibility to perform the role. When the nature and extent of the consultations become significant, the reviewer's objectivity may be impaired unless both the engagement team and the reviewer are careful to maintain the reviewer's objectivity. When this is not possible, another individual within the firm or a suitably qualified external person may be appointed to take on the role of either the engagement quality control reviewer or the person to be consulted on the engagement.

#### *Objectivity of the Engagement Quality Control Reviewer (Ref: par. .43–.44)*

##### Considerations Specific to Smaller Firms

**.A50** Suitably qualified external persons may be contracted when sole practitioners or small firms identify engagements requiring engagement quality control reviews and no person in the firm meets the eligibility requirements for an engagement quality control reviewer. Alternatively, some sole practitioners or small firms may wish to use other firms to facilitate engagement quality control reviews. When the firm contracts suitably qualified external persons or other firms, the requirements in paragraphs .43–.44 and the guidance in paragraph .A49 apply.

**Differences of Opinion (Ref: par. .46)**

**.A51** Effective procedures encourage identification of differences of opinion at an early stage, provide clear guidelines about the successive steps to be taken thereafter, and require documentation regarding the resolution of the differences and the implementation of the conclusions reached.

**.A52** Procedures to resolve such differences may include consulting with another practitioner or firm or a professional or regulatory body.

**Engagement Documentation***Completion of the Assembly of Final Engagement Files (Ref: par. .49)*

**.A53** Professional standards, law, or regulation may prescribe the time limits by which the assembly of final engagement files for specific types of engagements is to be completed. When no such time limits are prescribed, paragraph .49 requires the firm to establish time limits that reflect the need to complete the assembly of final engagement files on a timely basis.

**.A54** When two or more different reports are issued regarding the same subject matter information of an entity, the firm's policies and procedures relating to time limits for the assembly of final engagement files address each report as if it were for a separate engagement. This may, for example, be the case when the firm issues an auditor's report on financial information prepared in accordance with generally accepted accounting principles and, at a subsequent date, an auditor's report on the same financial information prepared in accordance with a special purpose framework for regulatory purposes.

*Confidentiality, Safe Custody, Integrity, Accessibility, and Retrievability of Engagement Documentation (Ref: par. .50)*

**.A55** Relevant ethical requirements establish an obligation for the firm's personnel to observe at all times the confidentiality of information contained in engagement documentation, unless specific client authority has been given to disclose information or a legal or professional duty exists to do so. Specific laws or regulations may impose additional obligations on the firm's personnel to maintain client confidentiality, particularly when data of a personal nature are concerned.

**.A56** Whether engagement documentation is in paper, electronic, or other media, the integrity, accessibility, or retrievability of the underlying data may be compromised if the documentation could be altered, added to, or deleted without the firm's knowledge or if it could be permanently lost or damaged. Accordingly, controls that the firm designs and implements to avoid unauthorized alteration or loss of engagement documentation may include those that

- enable the determination of when and by whom engagement documentation was prepared or reviewed;
- protect the integrity of the information at all stages of the engagement, especially when the information is shared within the engagement team or transmitted to other parties via electronic means;
- prevent unauthorized changes to the engagement documentation; and
- allow access to the engagement documentation by the engagement team and other authorized parties, as necessary, to properly discharge their responsibilities.

**.A57** Controls that the firm designs and implements to maintain the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation may include the following:

- The use of a password by engagement team members and data encryption to restrict access to electronic engagement documentation to authorized users
- Appropriate back-up routines for electronic engagement documentation at appropriate stages during the engagement
- Procedures for properly distributing engagement documentation to the team members at the start of the engagement, processing it during the engagement, and collating it at the end of the engagement
- Procedures for restricting access to, and enabling proper distribution and confidential storage of, hard copy engagement documentation

**.A58** For practical reasons, original paper documentation may be electronically scanned or otherwise copied to another media for inclusion in engagement files. In such cases, the firm's procedures designed to maintain the integrity, accessibility, and retrievability of the documentation may include requiring the engagement teams to

- generate scanned copies that reflect the entire content of the original paper documentation, including manual signatures, cross-references, and annotations.
- integrate the scanned copies into the engagement files, including indexing and signing off on the scanned copies as necessary.
- enable the scanned copies to be retrieved and printed as necessary.

There may be legal, regulatory, or other reasons for a firm to retain original paper documentation.

*Retention of Engagement Documentation (Ref: par. .51)*

**.A59** The needs of the firm for retention of engagement documentation and the period of such retention will vary with the nature of the engagement and the firm's circumstances (for example, whether the engagement documentation is needed to provide a record of matters of continuing significance to future engagements). The retention period may also depend on other factors, such as whether professional standards, law, or regulation prescribe specific retention periods for certain types of engagements or whether generally accepted retention periods exist in the absence of specific legal or regulatory requirements.

**.A60** In the specific case of audit engagements, the retention period would be no shorter than five years from the report release date.<sup>3</sup>

**.A61** Procedures that the firm may adopt for retention of engagement documentation include those that enable the requirements of paragraph .51 to be met during the retention period, such as, for example, procedures to

- enable the retrieval of, and access to, the engagement documentation during the retention period, particularly in the case of electronic documentation because the underlying technology may be upgraded or changed over time.

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<sup>3</sup> Paragraph .17 of AU-C section 230, *Audit Documentation*. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]



- provide, when necessary, a record of changes made to engagement documentation after the assembly of engagement files has been completed.
- enable authorized external parties to access and review specific engagement documentation for quality control or other purposes.

#### *Ownership of Engagement Documentation*

**.A62** Unless otherwise specified by law or regulation, engagement documentation is the property of the firm. The firm may, at its discretion, make portions of, or extracts from, engagement documentation available to clients, provided that such disclosure does not undermine the validity of the work performed or, in the case of assurance engagements, the independence of the firm or its personnel.

## Monitoring

### ***Monitoring the Firm's Quality Control Policies and Procedures (Ref: par. .52)***

**.A63** The purpose of monitoring compliance with quality control policies and procedures is to assess, for the system of quality control as a whole, whether the firm is achieving the objective described in paragraph .12 through an evaluation of the following:

- Adherence to professional standards and applicable legal and regulatory requirements
- Whether the system of quality control has been appropriately designed and effectively implemented
- Whether the firm's quality control policies and procedures have been operating effectively so that reports that are issued by the firm are appropriate in the circumstances

The evaluation may identify circumstances that necessitate changes to, or improve compliance with, the firm's policies and procedures to provide the firm with reasonable assurance that its system of quality control is effective.

**.A64** Ongoing consideration and evaluation of the system of quality control may include matters such as the following:

- Review of selected administrative and personnel records pertaining to the quality control elements
- Review of engagement documentation, reports, and clients' financial statements
- Discussions with the firm's personnel
- Determination of corrective actions to be taken and improvements to be made in the system, including providing feedback into the firm's policies and procedures relating to education and training
- Communication to appropriate firm personnel of weaknesses identified in the system, in the level of understanding of the system, or compliance with the system
- Follow-up by appropriate firm personnel so that necessary modifications are promptly made to the quality control policies and procedures

**.A65** Monitoring procedures also may include an assessment of the following:

- The appropriateness of the firm's guidance materials and any practice aids
- New developments in professional standards and legal and regulatory requirements and how they are reflected in the firm's policies and procedures, when appropriate
- Written confirmation of compliance with policies and procedures on independence
- The effectiveness of continuing professional development, including training
- Decisions related to acceptance and continuance of client relationships and specific engagements
- Firm personnel's understanding of the firm's quality control policies and procedures and implementation thereof

**.A66** Some of the monitoring procedures discussed previously may be accomplished through the performance of the following:

- Engagement quality control review
- Review of engagement documentation, reports, and clients' financial statements for selected engagements after the report release date
- Inspection procedures

Reviews of the work or report when performed by engagement team members prior to the date of the report are not monitoring procedures.

**.A67** The need for, and extent of, inspection procedures depends, in part, on the existence and effectiveness of the other monitoring procedures. The nature of inspection procedures varies based on the firm's quality control policies and procedures and the effectiveness and results of other monitoring procedures.

**.A68** The inspection of a selection of completed engagements may be performed on a cyclical basis. For example, engagements selected for inspection may include at least one engagement for each engagement partner over an inspection cycle that spans three years. The manner in which the inspection cycle is organized, including the timing of selection of individual engagements, depends on many factors, such as the following:

- The size of the firm
- The number and geographical location of offices
- The results of previous monitoring procedures
- The degree of authority of both personnel and office (for example, whether individual offices are authorized to conduct their own inspections or whether only the head office may conduct them)
- The nature and complexity of the firm's practice and organization
- The risks associated with the firm's clients and specific engagements

**.A69** Inspection procedures with respect to the engagement performance element of a quality control system are particularly appropriate in a firm with more than a limited number of management-level individuals responsible for the conduct of its accounting and auditing practice.

.A70 The inspection process involves the selection of individual engagements, some of which may be selected without prior notification to the engagement team. In determining the scope of the inspections, the firm may take into account the scope or conclusions of a peer review or regulatory inspections.

### ***The Relationship of Peer Review to Monitoring***

.A71 A peer review does not substitute for all monitoring procedures. However, because the objective of a peer review is similar to that of inspection procedures, a firm's quality control policies and procedures may provide that a peer review conducted under standards established by the AICPA may substitute for the inspection of engagement documentation, reports, and clients' financial statements for some or all engagements for the period covered by the peer review.

#### *Considerations Specific to Smaller Firms*

.A72 In small firms with a limited number of persons with sufficient and appropriate experience and authority in the firm, monitoring procedures may need to be performed by some of the same individuals who are responsible for compliance with the firm's quality control policies and procedures. This includes review of engagement working papers, reports, and clients' financial statements by the engagement partner or other qualified personnel after the report release date. To effectively monitor one's own compliance with the firm's policies and procedures, it is necessary that an individual be able to critically review his or her own performance, assess his or her own strengths and weaknesses, and maintain an attitude of continual improvement. Changes in conditions and the environment within the firm (such as obtaining clients in an industry not previously serviced or significantly changing the size of the firm) may indicate the need to have quality control policies and procedures monitored by another qualified individual.

.A73 Having an individual inspect his or her own compliance with a quality control system may be less effective than having such compliance inspected by another qualified individual. When one individual inspects his or her own compliance, the firm has a higher risk that noncompliance with policies and procedures will not be detected. Accordingly, a firm with a limited number of persons with sufficient and appropriate experience and authority in the firm may find it beneficial to engage a suitably qualified external person or another firm to perform engagement inspections and other monitoring procedures.

### ***Communicating Deficiencies (Ref: par. .55)***

.A74 The reporting of identified deficiencies to individuals other than the relevant engagement partners need not include an identification of the specific engagements concerned, unless such identification is necessary for the proper discharge of the responsibilities of the individuals other than the engagement partners.

### ***Complaints and Allegations***

#### *Source of Complaints and Allegations (Ref: par. .60)*

.A75 Complaints and allegations of noncompliance with the firm's system of quality control (which do not include those that are clearly frivolous) may originate from within or outside the firm. They may be made by firm personnel, clients, state boards of accountancy, other regulators, or other third parties. They may be received by engagement team members or other firm personnel.

*Investigation Policies and Procedures (Ref: par. .61)*

**.A76** Policies and procedures established for the investigation of complaints and allegations may include, for example, that the partner supervising the investigation

- has sufficient and appropriate experience,
- has authority within the firm, and
- is otherwise not involved in the engagement.

The partner supervising the investigation may involve legal counsel as necessary.

*Considerations Specific to Smaller Firms*

**.A77** In the case of firms with few partners, it may not be practicable for the partner supervising the investigation not to be involved in the engagement. These small firms and sole practitioners may use the services of a suitably qualified external person or another firm to carry out the investigation into complaints and allegations.

**Documentation of the System of Quality Control (Ref: par. .62)**

**.A78** The form and content of documentation evidencing the operation of each of the elements of the system of quality control is a matter of judgment and depends on a number of factors, including the following:

- The size of the firm and the number of offices
- The nature and complexity of the firm's practice and organization

For example, large firms may use electronic databases to document matters such as independence confirmations, performance evaluations, and the results of monitoring inspections.

**.A79** Appropriate documentation relating to monitoring includes, for example, the following:

- Monitoring procedures, including the procedure for selecting completed engagements to be inspected
- A record of the evaluation of the following:
  - Adherence to professional standards and applicable legal and regulatory requirements
  - Whether the system of quality control has been appropriately designed and effectively implemented
  - Whether the firm's quality control policies and procedures have been appropriately applied so that the reports that are issued by the firm are appropriate in the circumstances
- Identification of the deficiencies noted, an evaluation of their effect, and the basis for determining whether and what further action is necessary

***Considerations Specific to Smaller Firms***

**.A80** Smaller firms may use more informal methods in the documentation of their systems of quality control, such as manual notes, checklists, and forms.

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## **Exhibit—Comparison of Section 10, *A Firm's System of Quality Control*, and International Standard on Quality Control 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements***

This analysis was prepared by the AICPA Audit and Attest Standards staff to highlight substantive differences between section 10, *A Firm's System of Quality Control*, and International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*, and the rationale therefore. This analysis is not authoritative and is prepared for informational purposes only. It has not been acted on or reviewed by the Auditing Standards Board (ASB).

### **Differences in Language**

The ASB has made various changes to the language throughout section 10, as compared with ISQC 1. Such changes have been made to use terms applicable in the United States and to make section 10 easier to read and apply. The ASB believes that such changes will not create differences between the application of ISQC 1 and the application of section 10.

### **Requirements in Section 10 Not in ISQC 1**

Section 10 requires firms to establish policies and procedures providing

- in paragraph .30, for obtaining an understanding with the client regarding the nature, scope, and limitations of the services to be performed.
- in paragraph .33, that personnel selected for advancement have the qualifications necessary for fulfillment of the responsibilities they will be called on to assume.
- in paragraph .44, that although the engagement quality control reviewer is not a member of the engagement team, the engagement quality control reviewer should satisfy the independence requirements relating to the engagements reviewed.
- in paragraph .48, that when differences of opinion exist, a member of the engagement team be able to document that member's disagreement with the conclusions reached, after appropriate consultation.

ISQC 1 does not have equivalent requirements.

## Requirements in ISQC 1 Not in Section 10

Paragraph 25 of ISQC 1 requires the firm to establish policies and procedures setting out criteria for determining the need for safeguards to reduce the familiarity threat to an acceptable level when using the same senior personnel on an assurance engagement over a long period of time. The ASB believes that the familiarity threat should not be singled out among other threats to independence.

Paragraph 48(a) of ISQC 1 requires including, on a cyclical basis, inspection of at least one completed engagement for each engagement partner as a monitoring procedure. The ASB believes that this requirement is overly prescriptive and that a risk-based approach to inspections is more appropriate.

## Requirements in ISQC 1 Revised in Section 10

Paragraph .41 of section 10 requires that when an engagement quality control review is performed, the engagement quality control review be completed before the report is released. Paragraph 36 of ISQC 1 requires that the quality control review be completed before the report is dated. The ASB believes that an engagement quality control review is an independent review of the engagement team's significant judgments, including the date selected by the engagement team to date the report. As noted in the application material to section 10, when the engagement quality control review results in additional procedures having to be performed, the date of the report would be changed.

Paragraph 48(c) of ISQC 1 requires that those performing the engagement or the engagement quality control review are not involved in inspecting the engagements. Paragraph .53c of section 10, consistent with the requirement in paragraph 100 of Statement on Quality Control Standards No. 7, *A Firm's System of Quality Control*, requires that performance of monitoring of the firm's system of quality control be assigned to qualified individuals. Paragraph .A72 of section 10 notes that in small firms with a limited number of persons with sufficient and appropriate experience and authority in the firm, monitoring procedures may need to be performed by some of the same individuals who are responsible for compliance with the firm's quality control policies and procedures. The ASB concluded that it was not necessary to change existing practice because in the United States, the peer review process provides a safeguard and provides evidence that the monitoring procedures are effective.

Paragraph A49 of ISQC 1 references the requirement in paragraph 40 of ISQC 1 to establish policies and procedures to maintain the objectivity of the engagement quality control reviewer and states, "Accordingly, such policies and procedures provide. . . ." The ASB believes that notwithstanding its placement as application material, the language is indicative of a requirement and, accordingly, has included a requirement for the provision of these specific policies and procedures in paragraph .44 of section 10. The ASB believes this will not create a difference in the application of ISQC 1 and the application of section 10.

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

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