

Checkpoint Contents

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Editorial Materials

Accounting Services

Quality Control—Compilation and Review

Chapter 1 Quality Control—An Overview

100 Introduction

100 Introduction

100.1 Quality. A simple, yet powerful word. The *American Heritage Dictionary* defines *quality* as a “degree or grade of excellence.” For a CPA firm, the performance of high-quality professional services is essential to ensuring the firm's success, profitability, and longevity. A firm's system of quality control is the bedrock upon which its accounting and auditing practice is based. It provides a structure for performing engagement procedures and a safety net for helping to ensure that the firm's reports are appropriate in the circumstances. An effective quality control system very often reflects a firm's commitment to quality at all levels, which usually results in high quality services.

What Is Quality Control?

100.2 The AICPA revised *Code of Professional Conduct*¹ requires members to practice in firms that implement and maintain quality control procedures to ensure that services delivered to clients are competently performed and adequately supervised. Statements on Quality Control Standards (SQCSs) are standards issued by the AICPA Auditing Standards Board (ASB) to provide the framework for developing and maintaining an effective system of quality control. Firms that have accounting and auditing practices are required to follow the quality control (QC) standards.

100.3 What Is an Accounting and Auditing Practice?

QC 10.13 defines an *accounting and auditing practice* as a practice that performs audit, attestation, compilation, review, and any other services for which standards have been established by the AICPA Auditing Standards Board (ASB) or the AICPA Accounting and Review Services Committee (ARSC) under the *General Standards Rule* (ET 1.300.001) and the *Compliance with Standards Rule* (ET 1.310.001) of the AICPA revised *Code of Professional Conduct*. (See also the discussion beginning at paragraph 801.10 for how the Peer Review Standards define accounting and auditing practice.) Thus, quality control standards apply to virtually all accounting and auditing services covered by AICPA pronouncements, including the SSARS and attestation standards. Engagements performed in accordance with standards established by *other* AICPA technical committees are not considered to be accounting and auditing services. For example, quality control standards do not apply to consulting services or valuation services because standards for those services are not established by the ASB or ARSC.

100.4 What Is a Compilation and Review Practice?

Throughout this *Guide*, the authors use the term *compilation and review practice* to refer to firms that perform preparation,² compilation, review, and attestation services other than examinations. Thus, a compilation and review practice is a subset of an *accounting and auditing practice* as defined in paragraph 100.3. This *Guide* was created to assist firms that have compilation and review practices in developing, implementing, maintaining, and monitoring their quality control systems in an efficient and effective manner.

100.5 A firm with a compilation and review practice may provide the following services:

- Services covered by the SSARS—

- Preparation engagements.

- Compilation engagements.

- Review engagements.

- Services covered by the SSAEs—

- Reviews.

- Agreed-upon procedures engagements, including engagements to apply agreed-upon procedures to specified elements, accounts, or items of a financial statement.

- Compilations of prospective financial statements.

What Is the Purpose of a Quality Control System?

100.6 The purpose of a quality control system is to promote quality in performing accounting and auditing engagements. The QC standard indicates that a firm's system of quality control is a system designed to provide the firm with reasonable assurance that (a) the firm and its personnel are complying with professional standards and applicable legal and regulatory requirements and (b) that reports issued by the firm are appropriate in the circumstances. In developing and maintaining its quality control system, a firm establishes policies designed to achieve the objectives associated with obtaining reasonable assurance and procedures required to implement and monitor compliance with those policies.

System Review vs. Engagement Review

100.7 All AICPA member firms with an accounting and auditing practice as defined by the AICPA *Code of Professional Conduct* (see paragraph 100.3) are required to have a system of quality control. All such firms are also required to have a peer review performed every three years, as explained more fully in Chapter 8. The types of engagements performed by an accounting and auditing practice firm determines whether the firm is subject to a system review or an engagement review for its required peer review. Firms that perform audit engagements under the auditing standards or *Government Auditing Standards*; examinations under the SSAEs; or audits of non-SEC issuers performed under the standards of the PCAOB as their highest level of service are required to have a system review every three years. Firms that have an accounting and auditing practice, but do not perform the types of engagements that require a system review and instead perform only services under the SSARS or services under the SSAEs (excluding examinations), should undergo an engagement review every three years, but may elect to have a system review.

100.8 This *Guide* has been designed for firms that are subject to engagement review. As previously mentioned, this *Guide* assists firms that have compilation and review practices in developing, implementing, maintaining, and monitoring their quality control systems in an efficient and effective manner. It also provides compilation and review firms with information about undergoing engagement review. Firms that are subject to system review need to use *PPC's Guide to Quality Control* instead of this *Guide*.

Chapter Overview

100.9 This chapter provides an overview of quality control, which is the foundation for the material in the rest of the *Guide*. This chapter discusses—

- SQCS No. 8 (QC 10) requirements.
- The importance of the firm's commitment to quality in developing and maintaining an effective system of quality control.
- The steps involved in developing and implementing an effective QC system.

- Things to consider in drafting the firm's QC policies and procedures.
- Maintaining the firm's QC system.
- How practice monitoring affects the firm's QC system and the purpose of the AICPA peer review program.
- A summary of the topics included in the remainder of this *Guide*.

100.10 Use of the Term *Partner*.

This *Guide* often uses the term *partner* (for example, partner, engagement partner, accounting partner, or managing partner). For firms structured in legal forms other than partnerships (such as professional corporations and limited liability partnerships), this term is meant to be viewed as interchangeable with *shareholder* or *member*. Use of the term *partner* is not intended to imply that the firm is operating as a partnership.³

¹ In June 2014, the AICPA issued a revised *Code of Professional Conduct*, which restructured and reformatted the Code. The revised Code was generally effective on December 15, 2014. This *Guide* has been fully updated for the revised Code. See section 301 for further information about the revised Code.

² In October 2014, ARSC issued SSARS No. 21, *Statements on Standards for Accounting and Review Services: Clarification and Recodification*. AR-C 70, *Preparation of Financial Statements*, is one of four sections included in SSARS No. 21 and provides guidance for that type of engagement. SSARS No. 21, which will supersede all outstanding SSARS through No. 20 (except for SSARS No. 14, which is currently being redrafted), is effective for periods ending on or after December 15, 2015, with early implementation permitted. SSARS No. 21 is addressed throughout this *Guide*, but an overall discussion of the new statement can be found beginning at paragraph 601.18.

³ The AICPA Professional Ethics Executive Committee (PEEC) adopted a new term, *partner equivalent*, solely for the purpose of applying the *Independence Rule* requirements of the AICPA *Code of Professional Conduct* and its related interpretations. The new definition captures accountants who have some of the same responsibilities as a partner during attest engagements, but

are not partners of the firm as defined in the *Code of Professional Conduct*. The new definition became effective for engagements covering periods beginning on or after December 15, 2014.

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Checkpoint Contents

Accounting, Audit & Corporate Finance Library

Editorial Materials

Accounting Services

Quality Control—Compilation and Review

Chapter 1 Quality Control—An Overview

101 Overview of SQCS No. 8 and Other Engagement-level QC Requirements

101 Overview of SQCS No. 8 and Other Engagement-level QC Requirements

101.1 In 2007, the ASB issued Statement on Quality Control Standard No. 7, *A Firm's System of Quality Control*, which superseded and replaced all of the quality control standards that existed at the time. SQCS No. 7 established standards and provided guidance for a CPA firm's responsibilities for its system of quality control over its accounting and auditing practice, effective for a firm's system of quality control as of January 1, 2009. In 2010, the ASB issued Statement on Quality Control Standard No. 8, *A Firm's System of Quality Control (Redrafted)*, which superseded SQCS No. 7 and was applicable to a CPA firm's system of quality control for its accounting and auditing practice as of January 1, 2012.

101.2 In 2011, the ASB reissued SQCS No. 8, *A Firm's System of Quality Control*, incorporating conforming changes resulting from the issuance of SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification*, also known as the clarified auditing standards. Those conforming changes did not revise any of the existing SQCS No. 8 guidance, but added cross-references to relevant AU-C sections. AR-C 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*, issued as part of SSARS No. 21,⁴ provides engagement-level quality control requirements for engagements performed under the SSARS. This *Guide* incorporates the requirements of SQCS No. 8 and the engagement-level quality control requirements of AR-C 60. See further discussion of those engagement-level QC requirements beginning at paragraph 101.15.

101.3 As mentioned in paragraph 100.6, the firm's system of quality control is a system designed to provide the firm with reasonable assurance that (a) the firm and its personnel are complying with professional standards and applicable legal and regulatory requirements and (b) reports issued by the firm are appropriate in the circumstances. That statement is the objective of SQCS No. 8. Additionally, SQCS No. 8 (QC 10.17) indicates that the firm must establish and maintain a system of quality control.

101.4 The firm's quality control system should consist of policies and procedures. The nature of the

policies and procedures the firm develops to obtain reasonable assurance and comply with the requirements of SQCS No. 8 will depend on various factors, such as the following:

- The size of the firm.

- The operating characteristics of the firm, for example:
 - Types of services provided.

 - Types of industries served.

 - Number of partners.

 - Number of professional personnel.

Professional Requirements of SQCS No. 8

101.5 SQCS No. 8 (QC 10.08) establishes two categories of professional requirements to describe the degree of responsibility the firm has for complying with the requirements of the QC standard. Those categories are—

- *Unconditional Requirements.* Unconditional requirements are those the firm must follow in all cases if the circumstances apply to the requirement. These requirements use the word *must*.

- *Presumptively Mandatory Requirements.* Firms are also expected to comply with presumptively mandatory requirements if the circumstances apply to the requirement; however, in rare situations, a departure from the requirement is allowed if the firm documents the justification and how alternative procedures that were performed were sufficient to achieve the objectives of the requirement. Presumptively mandatory requirements are identified by the word *should*. If the SQCS uses the words *should consider* for a procedure, the consideration of the procedure is presumptively required.

Throughout this *Guide*, the authors use the terms *must* and *should* in accordance with QC 10.08. The authors also use the term *is required* interchangeably with *should*.

101.6 The application and other material provides additional guidance on professional requirements or identifies other procedures or actions. While a firm is not required to perform the other procedures or actions, the information is relevant to the proper application of the requirements. The words *may*, *might*, and *could*, among others, are used to describe these actions and procedures. The application and other explanatory material may—

- Explain in more detail what a requirement means or is intended to cover.
- Include examples of policies and procedures that might be appropriate in the circumstances.
- Provide background information on matters addressed in the standard.

Definition of Terms in SQCS No. 8

101.7 Before there can be a meaningful discussion of how to establish and maintain an effective quality control system governing a firm's compilation and review practice, it is important to have a clear understanding of what the relevant terms in the standard mean. Appendix 1A provides a list of definitions included in SQCS No. 8.

Elements of a Quality Control System

101.8 SQCS No. 8 (QC 10.17) states that the firm's system of quality control should incorporate policies and procedures that address each of the following QC elements:

- Leadership responsibilities for quality within the firm (*tone at the top*).
- Relevant ethical requirements.
- Acceptance and continuance of client relationships and specific engagements.
- Human resources.

- Engagement performance.

- Monitoring.

Exhibit 1-1 presents a brief description of the QC elements in SQCS No. 8, along with how each element contributes to the objective of obtaining reasonable assurance regarding the effectiveness of the QC system and where they are discussed in this *Guide*.

Exhibit 1-1

The Elements of Quality Control in SQCS No. 8

QC Element	Designed to Provide Reasonable Assurance That:	Discussed in Chapter
Leadership Responsibilities for Quality Within the Firm (<i>Tone at the Top</i>)	The firm establishes policies and procedures to promote an internal culture that is based on the recognition that quality is essential in performing engagements.	2
Relevant Ethical Requirements	The firm and its personnel comply with relevant ethical requirements.	3
Acceptance and Continuance of Client Relationships and Specific Engagements	The firm undertakes or continues only client relationships and engagements in which the firm (a) considers the client's integrity and does not have information that would indicate the client lacks integrity; (b) determines the firm has the competence, capabilities, and resources to perform the engagement; and (c) determines the firm can comply with applicable legal and regulatory requirements.	4
Human Resources	The firm has sufficient personnel with the competence, capabilities, and commitment to ethical principles 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.	5
Engagement Performance	Work performed by engagement personnel consistently complies with professional standards and applicable legal and regulatory requirements, and the firm issues reports that are appropriate in the circumstances.	6

Documentation and Communication of the Firm's QC Policies and Procedures

101.9 SQCS No. 8 (QC 10.18) requires that the firm document its QC policies and procedures. Matters such as the nature of the firm's practice, its size, and its structure may be considered in determining the *extent* of documentation of the firm's QC policies and procedures. Documentation of the policies and procedures for a single-office firm with a small number of partners and staff would not be expected to be as extensive as those of a large, multi-office firm.

101.10 It is interesting to note that SQCS No. 8 does not require the firm to have a formal quality control policies and procedures *document*; instead, the standard indicates only that the firm's QC policies and procedures be *documented*. SQCS No. 8 allows the firm to have flexibility and latitude in determining the documentation method that best suits its individual practice and circumstances. (The use of the phrase *QC document* in this *Guide* is not meant to imply that firms need to document their policies and procedures in any particular manner.)

101.11 In addition to documenting its QC policies and procedures, QC 10.18 indicates that the firm should communicate its QC policies and procedures to firm personnel. That communication is not required to be in writing, although written communication is preferable. Effective firm communication of its QC policies and procedures, as described in QC 10.A2, generally incorporates the following:

- A description of the policies and procedures and the objectives they achieve.
- A message that each person is responsible for maintaining quality, as well as being familiar with the policies and procedures and complying with them.
- Comments stressing the importance of receiving feedback on how the QC system is operating and encouraging staff to communicate their concerns on quality control issues.

101.12 This documentation and communication requirement is applicable to firms that provide preparation, compilation, and review services, as well as firms that have an accounting and auditing practice, as defined at paragraphs 100.3-.4, and requires those firms to undergo a peer review at least once every three years. As a result, such firms should have in place a quality control system that will withstand such a review or risk termination of firm membership in the program, individual memberships in the AICPA, and, in some states, loss of their licenses to practice.

101.13 Relationship of SSARS to Quality Control Standards

Statements on Quality Control Standards relate to the conduct of a firm's entire accounting practice. SSARS relate to the performance of individual preparation, compilation, and review engagements. The quality control policies and procedures that a firm adopts could affect both the performance of an individual engagement and the firm's overall accounting practice. However, deficiencies or instances of noncompliance with a firm's quality control policies and procedures do not necessarily indicate that a specific preparation, compilation, or review engagement was not performed in accordance with SSARS.

Documentation Requirements of SQCS No. 8

101.14 SQCS No. 8 includes general documentation requirements, as well as various requirements to prepare and maintain documentation related to specific QC element areas. Those requirements are discussed throughout this *Guide* in the relevant topic areas. To assist the firm in determining whether it is complying with SQCS No. 8 documentation requirements, the authors have developed the "Quality Control Documentation Checklist" at GCR-PA-1.4, which summarizes the specific documentation requirements in one place. GCR-PA-1.4 covers the specific SQCS No. 8 documentation requirements, and does not include the documentation requirements of other engagement-related professional standards (i.e., SSARS and SSAEs).

Engagement-level Quality Control under SSARS 21 (AR-C 60)

101.15 AR-C 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*, provides general principles for firms to follow when performing an engagement under the new SSARS No. 21. AR-C 60 is a standard that directs the firm in more than applying quality control at the engagement level. However, it does provide certain engagement-level quality control requirements and guidance that the engagement partner should follow. While there is not a requirement for every QC element included in SQCS No. 8, several of the QC elements are specifically addressed in AR-C 60. The responsibility to ensure compliance with those engagement-level quality control requirements is primarily placed on the engagement partner. However, the related application guidance indicates that the engagement team also has responsibility to implement engagement-level quality control procedures. In meeting the requirements, the engagement team may rely on the firm's quality control system unless the firm or other parties have indicated that it is inappropriate to do so.

⁴ In October 2014, the Accounting and Review Services Committee (ARSC) issued SSARS No. 21, *Statements on Standards for Accounting and Review Services: Clarification and Recodification*, which becomes effective for engagements of financial statements for periods ending on or after December 15, 2015. However, early implementation is permitted for all sections of SSARS No. 21. See a detailed discussion of new SSARS No. 21 in section 601.

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Checkpoint Contents

Accounting, Audit & Corporate Finance Library

Editorial Materials

Accounting Services

Quality Control—Compilation and Review

Chapter 1 Quality Control—An Overview

102 Commitment to Quality

102 Commitment to Quality

102.1 Improving engagement quality is a foundational concept pervasive in SQCS No. 8. In order to capture the spirit of the QC standard, the firm needs to make a serious commitment to quality. The need for commitment cannot be emphasized too strongly, and it should be viewed by firm personnel as long-term and coming from the top down. Improving and maintaining excellence within the firm demands a commitment on the part of every individual.

102.2 To make a true commitment to quality, firm management has to exhibit effective leadership; change or reinforce firm culture; and devote sufficient financial, personnel, and physical resources to the quality control effort.

Effective Leadership

102.3 Effective leadership is an essential ingredient for success in most team-oriented endeavors. A commitment to quality compels firm management to lead by example through its expectations of, and insistence on, quality. The firm's partners have a responsibility to ensure that a commitment to quality is clearly embedded in the firm's values and culture. By their actions, the firm's partners can reflect an appropriate tone at the top that engenders a commitment to quality throughout the firm. In many cases, the ultimate determination of whether the firm maintains an effective system of quality control over time is largely a function of how well the firm's leadership group supports the QC system. See Chapter 2 for a detailed discussion regarding the responsibility of firm leadership to promote quality.

Firm Culture

102.4 An assessment of the firm's culture is an important step in the process of developing, improving, and keeping current a firm's system of quality control. *Firm culture* can be defined in this context as the shared assumptions, beliefs, and behaviors of firm personnel. To a large extent, what we do is determined by our culture. The same individual in two different firms may act in different ways, depending on the firm's culture.

102.5 Essential elements in sustaining a quality-conscious firm culture include an unwavering belief

in the importance of quality and adaptability and a cooperative attitude among partners. If those elements do not exist or exist to an insufficient degree, they need to be cultivated. In some cases, that may mean emphasizing to those who lack the appropriate attitude that the stakes are high. They may have to be reminded that failing to establish and maintain an effective system of quality control can have a crippling effect on the firm over time.

102.6 *Adaptability*, the willingness to change and support change, is a critical component of infusing a commitment to quality into firm culture. Adaptability may take the form of a new system of policies, procedures, and the related supporting documentation; a significant change to the existing system; or a requirement to hire additional technical personnel. In any case, the quality control effort will necessitate a willingness from firm personnel to accept those changes.

102.7 Likewise, developing, improving, and keeping the quality control system current will entail a cooperative attitude among the firm's partners. Passive resistance can sabotage the effort. If the firm's existing culture is deficient and needs to be changed or improved to instill a commitment to quality, such change or improvement may take time because cultural change is not easy. When a change in culture is needed, the effectiveness of the firm's leadership in promoting quality is critical.

102.8 Once new procedures are adopted, the message from firm leadership needs to be clear. The firm's commitment to quality will not be compromised, regardless of the engagement or the circumstances. No compilation or review service can be considered too insignificant or too rushed to dispense with required QC policies and procedures.

Dedication of Time and Resources

102.9 To establish and maintain an effective quality control system, the firm needs to devote the time and resources necessary to ensure that the QC system put into place is adequate and that it continues to be effective. It is important to recognize that there will be start-up costs associated with establishing a QC system and, unless the firm is willing to commit to those costs, the effort cannot succeed. It is important for the firm to make realistic assessment of the total investment in time, money, and personnel resources that will be necessary. The investment is ordinarily recouped in later years through improved efficiency and better-managed growth. Many firms recognize an even earlier recovery of their investment by implementing time-saving suggestions and eliminating unnecessary procedures uncovered as the quality control system is refined. In the initial stages, though, the effort to develop or improve a quality control system represents a resource commitment by the firm.

Benefits to the Firm of Establishing and Maintaining an Effective QC System

102.10 Delivering high quality services is the driver for success for most professional service firms, and CPA firms are no exception. As mentioned in paragraph 100.1, performing quality services is vital to increasing the firm's profitability, maximizing the firm's value, and potentially even guaranteeing its long-term succession plans and viability. Clearly, there are sound business reasons for establishing and maintaining an effective system of quality control. The most noteworthy of those reasons are to improve the quality of the firm's compilation and review services and increase its

efficiency in delivering those services.

102.11 Improved Quality of Work

It logically follows that an effective quality control system will yield an improved work product. Quality control measures reduce the risk of error and noncompliance with professional standards. Clearly communicated policies and procedures provide greater assurance to partners that staff members are performing appropriately and that the firm's work product is accurate and complete. In addition, improving work quality ordinarily has residual benefits, including improved staff morale and reduced litigation risk.

102.12 Improved Staff Morale.

Association with a firm that actively strives to perform high-quality services buttresses professionalism. It enhances the self-images of partners and staff, pride in the firm, and overall morale. A quality control system that is operating effectively will often have an especially beneficial effect on staff morale, and ultimately staff retention, because of the heightened emphasis placed on professional development, career counseling, advancement, and related matters that are important to staff.

102.13 Reduced Risk of Litigation.

The risk of being involved in a lawsuit, or more importantly, the risk of having a successful suit brought against the firm, can be minimized by a QC system that reduces the potential for error and increases the quality of engagement and other required documentation. In our current litigious environment, the benefits, although difficult to quantify, are quite real. In addition, successful completion of a peer review may also help to reduce the firm's professional liability insurance cost. (The peer review process and undergoing a peer review are discussed in Chapter 8.)

102.14 Increased Efficiency in Delivering Services.

Over time, as the quality control system is refined and the administrative and operating procedures are improved, the general efficiency of the firm's quality control system operations often increases. Documentation, standardization, and consistency of operations usually have the effect of improved productivity. This is particularly important as the firm and its staff grows. It is during periods of growth that operational efficiency and structure become increasingly critical to ensuring that the firm continues performing high-quality engagements. The lack of such structure and systemization can cause a firm to lose its competitive edge.

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Checkpoint Contents

Accounting, Audit & Corporate Finance Library

Editorial Materials

Accounting Services

Quality Control—Compilation and Review

Chapter 1 Quality Control—An Overview

103 Developing and Implementing an Effective QC System

103 Developing and Implementing an Effective QC System

103.1 There is not just one right approach to developing and implementing a system of quality control. However, a general project management approach that may be used by the accounting partner is outlined in this section. More specific recommendations regarding each of the individual elements of quality control are provided in Chapters 2-7 of this *Guide*. Taken in chronological order, the authors believe that firms can benefit from performing the following steps:

- Set a realistic timetable for implementation.
- Accumulate and review all relevant professional literature.
- Assess the current status of the firm's QC policies and procedures and establish a plan for developing the system.
- Review the plan and timetable with the other partners.
- Develop quality control policies and procedures for all elements and relevant activities of quality control.
- Communicate the policies and procedures to firm partners and other professionals to initiate implementation of the system.

- Monitor implementation of the system and provide additional training to individuals or groups, as needed.

- Perform monitoring procedures on the system and make modifications as necessary.

103.2 GCR-PA-1.1 and GCR-PA-1.2 present these steps in a checklist format that can be used for developing and implementing a quality control system. The checklists provide an overview of the development and implementation process, as well as references to the sections of this *Guide* that contain the appropriate guidance. The checklists allow firms that have read this *Guide* to focus on the specific chapters and sections that are most relevant to their practices in developing and implementing an effective quality control system.

Setting a Realistic Timetable for Implementation

103.3 Before the firm is ready to begin the process of establishing a QC system, a realistic timetable for completing the project needs to be established. It is important for the timetable to consider when the firm will be undergoing its first or next review. Firms that enroll in the AICPA Peer Review Program generally have only 18 months during which to implement an effective QC system and undergo their first review. Newly formed firms with AICPA members and other firms that will be required to have a peer review for the first time are required to establish an appropriate quality control system as soon as practical after the firm is established. As a result, those firms need to set their timetables to ensure that their quality control systems are in place within the first few months, if possible, so their QC systems are fully operational prior to the commencement of the firm's first peer review. (See section 106 for a discussion of practice monitoring and Chapter 8 for a detailed discussion of the peer review process.)

103.4 The authors believe that a realistic (although ambitious) timetable for implementing a quality control system within an 18-month period could be apportioned as follows:

- First two months—develop and implement the system.
- Next 12 months—complete one year's work (the peer review period) and monitor the QC system.
- Last four months—complete the first peer review.

103.5 It is unlikely the firm can successfully meet this ambitious timetable unless the project is given a high priority. It takes some firms significantly longer than anticipated to implement and refine their systems to a point where they are ready to undergo peer review.

Reviewing Relevant Professional Literature

103.6 The nature of the professional literature that is relevant will vary with each element of quality control and the type of services the firm provides. Ordinarily, professional literature for compilation and review firms will consist of authoritative literature (such as the AICPA's SSARS and SSAEs and the *Code of Professional Conduct*), the requirements of various professional associations (state societies of CPAs, etc.), and the requirements of various regulatory bodies (state boards of accountancy and other regulatory agencies that regulate clients' industries). Specific guidance for each element is highlighted in each of the chapters that discuss those elements.

Assessing the Current QC System and Establishing a Plan

103.7 In this planning stage, the individual designated by the firm to be responsible for developing the QC system (usually the accounting partner) obtains the information necessary to begin developing an implementation plan. (See section 204 for a discussion of the role of the accounting partner.) Since most firms have some aspects of a quality control system already in place, the firm would ordinarily perform an analysis of the existing system first. The extent to which aspects of a system already exist will impact how much additional work needs to be done to put an effective QC system in place. Documentation of existing policies and procedures can be reviewed to determine what is still relevant. The firm can then devise an implementation plan that reflects what remains to be done and considers the resources needed.

Reviewing the Plan and Timetable with Partners

103.8 It is appropriate for the accounting partner to present the plan and timetable to the partner group. How formal and structured such a presentation is will depend on the size and operating style of the firm. However, in considering how elaborate to make the presentation, keep in mind that this is the primary communication device to elicit the support of the partner group. The presenter needs to provide whatever information is considered necessary to obtain partner cooperation and commitment to the project.

Developing the QC Policies and Procedures

103.9 The drafting of the firm's policies and procedures and related documentation is discussed in detail for each element and activity of the system in Chapters 2-7. In addition, the practice aids within this *Guide* provide the authors' suggested policies and procedures relating to each QC element and activity. These suggested procedures can be used as a starting point for drafting the firm's QC document. See section 104 for a more detailed discussion on drafting the firm's QC policies and procedures.

Communicating the QC Policies and Procedures to all Professionals

103.10 The nature and format of such a communication is generally a function of firm size. For firms with a sufficient number of professionals to warrant it, a seminar or formal presentation may be desirable. This step represents the introduction of the QC system to firm personnel. It is the beginning of the implementation stage. To reach this point, the following conditions ordinarily exist:

- Agreement has been reached regarding all aspects of the system.
- Access to the firm's policies and procedures is readily available to all professional staff.
- Forms, checklists, and other necessary practice aids and documentation are readily available.

When a seminar or formal presentation is conducted, the firm might desire to have the session qualify for in-house CPE credit. See Chapter 5 on professional development for a discussion on designing in-house CPE programs.

Monitoring Implementation of the QC System and Providing Additional Training

103.11 Monitoring the progress of the QC system implementation is an ongoing process designed to determine that the policies and procedures put into place by the firm are appropriately designed and operating effectively. This will generally require the accounting partner to:

- Actively inquire whether the partners and staff understand and adhere to new policies and procedures and use the related forms and checklists.
- Create a mechanism for staff to openly communicate any problems or issues that occur when performing engagement services. This may include forming a quality assurance committee, composed of all levels of professionals, to discuss issues that arise and propose suggestions for improvements.
- Perform periodic spot inspections/reviews of workpapers, reports, forms, and checklists to determine whether or not the system is functioning properly.

103.12 In performing the procedures described in paragraph 103.11, the accounting partner will often identify areas for improvement. The accounting partner then determines what changes are needed in the firm's QC policies and procedures. Once that is done, it may be beneficial to provide training to specific individuals or groups regarding modifications to the QC policies and procedures to ensure

that those involved both understand and comply with the changes.

Performing Monitoring Procedures on the System and Making Modifications

103.13 Monitoring procedures are performed to determine whether the firm's quality control policies and procedures are working properly and are being complied with in practice. Naturally, this assumes that the system has been designed, implemented, and fine-tuned. In many cases, monitoring procedures may identify situations that require remedial action. This is particularly true with regard to a newly-introduced system. (See Chapter 7 for a detailed discussion of monitoring procedures.)

103.14 Designing, or significantly modifying, and implementing a firm's quality control system is not generally an endeavor that will be completely correct the first time. As the new, or significantly modified, QC system starts getting used by the firm, both small and not-so-small changes may need to be incorporated into the QC system before firm leadership starts to feel like they have developed the right system for the firm. Thus, firms can expect a period of continued modifications to the QC system after it is first implemented.

103.15 Obtaining External QC Consulting Assistance.

For some firms, especially those whose partners specialize in tax work, the task of implementing a QC system over their compilation and review practice may be especially challenging. The ongoing demands of the practice or the lack of familiarity with formalized administrative and supervisory systems may make it extremely difficult to develop and implement a QC system in a timely manner. If a firm fits into this category, the firm's time, money, and effort might best be spent hiring a firm of comparable size or a consultant to assist in implementing the system. Ideally, firms hired for such assistance have already had a peer review and received a report with a rating of *pass*.

END OF DOCUMENT -

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Checkpoint Contents

Accounting, Audit & Corporate Finance Library

Editorial Materials

Accounting Services

Quality Control—Compilation and Review

Chapter 1 Quality Control—An Overview

104 Drafting QC Policies and Procedures

104 Drafting QC Policies and Procedures

104.1 What is the difference between a quality control system and a quality control document? The quality control document is the *written form of the system*. It represents the documented policies and procedures and the related forms, checklists, etc., that support those policies and procedures. As discussed in section 101, SQCS No. 8 requires that the firm document its policies and procedures. However, the extent to which the firm documents such policies and procedures may vary depending on its size, structure, and nature of the practice. The authors believe that many small and medium-sized firms can comply with the requirement to document its QC policies and procedures without designing a sophisticated QC system.

104.2 As discussed at paragraph 101.9, the firm is required to comply with all requirements of SQCS No. 8, including considering whether other matters or circumstances exist within the firm that require it to establish additional QC policies and procedures to satisfy the objective of the quality control standard. On the other hand, the authors recommend that firms avoid unnecessary policies and procedures, as they can create an excessive and burdensome QC system that is difficult to comply with. For example, a firm with four professional staff members might not need to adopt policies requiring a formal staff evaluation for every job of 80 hours or more. For that size firm, such a policy may be excessive, with no comparable contribution to the quality of the firm's practice. Instead, the firm might adopt a policy requiring oral evaluations after every engagement of 150 hours or more, with an annual formal (written) evaluation. The authors believe that firms should attempt to achieve a balance between designing a detailed and structured QC system and a system that complies with the QC standard as simply and straightforward as possible, based on the firm's facts and circumstances.

Creating a Comprehensive Quality Control Document

104.3 Many firms, especially smaller ones, may prefer to document their quality control system in the form of an all-inclusive statement that contains the firm's policies and procedures relating to the elements and activities of quality control. This approach may also include the relevant documents (forms, checklists, etc.) for illustrative purposes; or, it may just make reference to them. If the latter

approach is chosen, it is important such documents to be maintained and readily available and accessible to all staff. Other firms with less complex quality control systems may choose to develop basic written QC policies and procedures that are relatively simple but address all the required elements under SQCS No. 8. The “Quality Control Policies and Procedures Drafting Form” at GCR-PA-13.4 provides a *fill-in-the-blank* type form for firms to document their quality control policies and procedures by QC element.

Referring to Personnel and Accounting Manuals

104.4 Some firms, generally larger ones, have separate personnel manuals and/or accounting manuals for their practices. These manuals generally contain some mix of policies, procedures, and documentation to cover personnel and technical matters. Firms that have such manuals may choose to create an abbreviated quality control document that makes reference to the appropriate procedures and documents within these manuals rather than to create a comprehensive quality control document.

104.5 Quality Control Materials.

Many other firms adopt, or adapt to their practices, accounting manuals developed by other large accounting firms or commercial publishers, referred to as *quality control materials* (QCM). For example, the PPC brand of accounting and auditing guides published by Thomson Reuters is widely used. A listing of PPC guides is available at tax.thomsonreuters.com.

104.6 Quality control materials (QCM) provide guidance to assist firms in performing and reporting in conformity with professional standards and may include, but are not limited to, engagement aids (including accounting and auditing manuals), checklists, questionnaires, work programs, computer-aided accounting and auditing tools, and similar materials designed to be used by accounting and auditing engagement teams. When designing the firm's quality control policies and procedures, the firm should indicate the QCM that are being used, or make reference to the firm's accounting manuals that contain the firm's QCM. Beginning at paragraph 605.17 is a discussion about the use of QCM, including the firm's responsibilities for evaluating the reliability and suitability of the QCM before adopting and integrating the materials into the quality control system. Because the QCM found in the PPC brand accounting and auditing guides are interrelated, the authors recommend their use. PPC brand accounting and auditing guides undergo peer review by an independent third party that includes the quality control system used in developing the materials.

104.7 A Caution about the Use of Abbreviated QC Documents

Although referencing to QC procedures contained in such manuals can greatly reduce the time needed to document the firm's QC system, there is one dangerous drawback to this approach. Seldom does a firm follow verbatim all of the policies and procedures contained in the manuals used by the firm. More often, the firm *adapts* the manuals to its own practice by using some of the checklists, forms, and procedures and discarding others. If the firm does not plan to follow all the procedures in its manuals, it needs to design some type of *bridging document* between its QC documents and the QCM to explain which procedures in the QCM are used. See beginning at

paragraph 605.16 for a discussion about creating bridging documents.

Considering the AICPA Quality Control Practice Aid

104.8 The AICPA issued guidance for developing QC policies and procedures in its Practice Aid, *Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice* (the AICPA Practice Aid). The AICPA Practice Aid provides illustrative examples of various types of policies and procedures a firm may consider when developing its system of quality control under the guidelines of SQCS No. 8. Illustrative examples of quality control documents are provided for four hypothetical firms varying in size, as follows:

- Firm with multiple offices.

- Single-office firm.

- Sole practitioner.

- An alternative practice structure (see discussion at paragraph 104.10).

104.9 The AICPA Practice Aid is not authoritative and only presents the recommendations of the AICPA Quality Control Standards Task Force on the applicability of the QC standard. Even so, the AICPA Practice Aid may be a good resource for use by the firm when drafting its QC policies and procedures.

104.10 Alternative Practice Structures.

Alternative practice structures are allowed by ET 1.810.050 of the AICPA revised *Code of Professional Conduct*, which states that a member may practice public accounting only in a form of organization permitted by law or regulation whose characteristics conform to resolutions of the AICPA Council. A Council resolution (ET Appendix B) allows non-CPA partnership in CPA firms, subject to certain conditions. The Council resolution requires that CPAs own a majority of the financial interests and voting rights of a firm engaged in attest services and remain responsible, financially and otherwise, for the attest work performed. An *alternative practice structure* (APS) is a nontraditional structure in which nonattest services are performed under public or private partnership and attest services are performed through a separate firm owned and controlled by a member. The authors believe that compilation and review practice firms are rarely part of an alternative practice structure. Accordingly, APS firms are not discussed in this *Guide*.

Considering the AICPA Peer Review Program Manual Questionnaires

104.11 As discussed in Chapters 2-7 of this *Guide*, the AICPA *Peer Review Program Manual* (PRPM) includes questionnaires for firms to complete prior to the commencement of a peer review (see Chapter 8). The PRPM questionnaires are designed by the Peer Review Board of the AICPA as suggested policies and procedures that firms are encouraged to consider in designing and maintaining a system of quality control. Accordingly, firms may consider this information when designing or revising the QC system. Having a general understanding of what is suggested by the AICPA for the QC system can be helpful when drafting the firm's policies and procedures.

104.12 The PRPM includes QC policies and procedures questionnaires for two categories of firms—firms with two or more professional staff and sole practitioners with no personnel. When developing and documenting a firm's QC system, it is often helpful to read the portions of the peer reviewers checklists and questionnaires that relate to the QC elements and activities for the appropriate size firm. These checklists provide insight as to what a reviewer would look for, which, in turn, will help the firm decide how much documentation it needs.

Model Quality Control Documents

104.13 To help firms develop their own QC documents, the authors have developed model QC documents at GCR-PA-13.1 through GCR-PA-13.4. GCR-PA-13.1 is a quality control document designed for a local one-office accounting firm that provides only compilation and review services (as defined in paragraph 100.4). However, the model QC documents are designed to be customized and can easily be tailored to the unique operations of each firm. It is important to remember that effective quality control system documentation needs to fit a firm's unique operations. Adapting the drafting forms is likely to be most beneficial for sole practitioners and firms small enough that partners are closely involved in all aspects of the firm's operations. Generally, those practices maintain a more informal style of management, and their QC policies and procedures do not need to be as extensive as those for a larger firm. Consequently, the authors have developed the following examples of how the model quality control document in GCR-PA-13.1 can be tailored:

- *GCR-PA-13.2* presents a QC document tailored for a sole practitioner firm with one or more professional staff that performs only compilation and review engagements.
- *GCR-PA-13.3* presents a QC document for a sole practitioner who performs only compilation and review engagements.
- *GCR-PA-13.4* presents a simple *fill-in-the-blank* type QC document drafting form a firm can use to document its quality control policies and procedures by QC element.

104.14 The model QC documents at GCR-PA-13.2 and GCR-PA-13.3 are intended only to provide examples of how the quality control document for small firms at GCR-PA-13.1 can be adapted. If a

firm uses GCR-PA-13.2, GCR-PA-13.3, or GCR-PA-13.4 to develop its QC system, consideration of the footnotes accompanying the related quality control element policies and procedures drafting forms presented at GCR-PA-2.1, GCR-PA-3.1, GCR-PA-4.1, GCR-PA-5.1, GCR-PA-11.1, and GCR-PA-12.1 is recommended. Considering those footnotes will ensure that the QC system truly fits the unique operations of the firm. A firm developing or reviewing its QC system may need to draw from portions of both the QC documents illustrated at GCR-PA-13.2 and GCR-PA-13.3. For example, a firm with two partners and no professional staff might select portions of GCR-PA-13.2 and GCR-PA-13.3 in drafting its unique QC document.

104.15 The model quality control documents, as well as the discussion in Chapters 2-7 of this *Guide*, will provide guidance to firms as they determine the amount of documentation necessary when designing their firm's QC system.

Quality Control System Assessment Practice Aids

104.16 The authors have provided practice aids for assessing the overall adequacy of a quality control system. The firm can use those practice aids to assess its current QC system and to make revisions where weaknesses are noted or where changes have occurred in the firm's practice. GCR-PA-14.1 and GCR-PA-12.3 or GCR-PA-12.4 provide a summary of what the quality control policies and procedures for each quality control element should address, and GCR-PA-12.2 provides a guide for testing compliance with the firm's stated quality control policies and procedures.

END OF DOCUMENT -

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Checkpoint Contents

Accounting, Audit & Corporate Finance Library

Editorial Materials

Accounting Services

Quality Control—Compilation and Review

Chapter 1 Quality Control—An Overview

105 Maintaining the Firm's QC System

105 Maintaining the Firm's QC System

105.1 It is apparent from the discussion of quality control policies and procedures in Chapters 2-7 that there are many tasks to be performed during the year that are essential to maintaining the QC system. Regardless of how quality-conscious firm management and staff are, important procedures may not be performed because someone simply forgets to perform them.

105.2 To guard against the possibility of forgetting to perform a critical administrative procedure required by the QC system, the authors suggest that firms (a) identify the administrative tasks required by the system, (b) assign responsibility for performing the tasks, and (c) schedule the tasks on a critical date calendar. Administrative tasks required by the system normally can be identified by reviewing the QC document. However, determining timing and frequency of such tasks requires a consideration of factors including (a) peak workloads (ideally, QC tasks are best performed during nonpeak periods); (b) lead time needed for feedback (for example, a firm generally desires to review CPE files in advance of its State Board deadlines so deficiencies can be identified and corrected); and (c) coordination with other administrative procedures.

QC Maintenance Calendar Drafting Form

105.3 GCR-PA-1.3 presents a calendar for maintaining the firm's QC policies and procedures discussed in Chapters 2-7. This practice aid can be used as a model to help design a maintenance calendar that is suitable for the firm's unique QC system.

END OF DOCUMENT -

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Checkpoint Contents

Accounting, Audit & Corporate Finance Library

Editorial Materials

Accounting Services

Quality Control—Compilation and Review

Chapter 1 Quality Control—An Overview

106 Practice Monitoring and Peer Review

106 Practice Monitoring and Peer Review

General

106.1 The AICPA *Code of Professional Conduct* requires members to practice in firms that have quality control procedures for ensuring that services are competently delivered. The bylaws of the AICPA include a requirement at BL Section 220 at 2.2.3 and BL Section 230 at 2.3.4 that persons engaged in public practice as an owner or as an employee who has been licensed as a CPA for more than two years, either:

- a. are practicing in a CPA firm that is enrolled in an AICPA-approved practice monitoring program if the firm performs services that are within the scope of the AICPA practice monitoring standards and the firm issues reports purporting to be in accordance with the AICPA professional standards, or
- b. if authorized by Council, are themselves enrolled in such a program. ⁵

106.2 Practice monitoring programs are intended to reduce substandard performance by CPA firms in their delivery of accounting and auditing services. This is accomplished by periodic peer review of firms' quality control systems. Currently, 48 states require firms engaged in accounting and auditing practice to have a peer review in order to be issued their practice unit license, regardless of whether the firm or its personnel are AICPA members. These factors have required and will continue to require many firms to either develop or improve their quality control systems so they can successfully complete a peer review. Also, firms that are enrolling in an AICPA practice monitoring program for the first time must have a system of quality control in order to successfully complete such a review.

106.3 Firms with partners or employees who are members of the AICPA and that are engaged in public practice must be enrolled in an AICPA practice-monitoring program (see paragraph 106.1).

This practice monitoring requirement is applicable to firms that provide compilation, review, audit, or attestation services and requires those firms to undergo a peer review at least once every three years. As a result, firms providing accounting and auditing services must have in place a quality control system that will withstand such a review or risk termination of firm membership in the program, individual memberships in the AICPA, and, in many states, loss of their licenses to practice.

106.4 It is also important to note that quality control requirements are not limited to this AICPA practice-monitoring initiative. Most state boards of accountancy have adopted or will be adopting some form of quality control review as a requirement for state licensing.

106.5 **Firm with No Accounting and Auditing Practice.**

The discussion in the earlier paragraphs of this section means that if a firm has no accounting and auditing practice, it is not required to participate in a practice monitoring program in order for its partners and employees to retain their AICPA memberships. However, a firm will generally be required to notify the AICPA when it accepts its first accounting and auditing client, and a peer review will be required within 18 months of the fiscal year-end of the first accounting and auditing engagement accepted.

106.6 **AICPA Peer Review Program.**

In a generic sense, *peer review* means a review of a firm's accounting and auditing practice (which may vary in scope, purpose, nature, and procedures) by peers, that is, an independent CPA or CPAs with experience and expertise in practice areas similar to those of the firm being reviewed. The AICPA established its first practice monitoring program in 1977. Called the Division for CPA Firms, it was a voluntary program built around the concept of member firms undergoing a clearly defined form of peer review. The AICPA description of the term seems to be the most widely used. It established qualifications for reviewers, guidelines and procedures to be followed, the frequency with which reviews are to be conducted (once every three years), and specific objectives.

106.7 The peer review process focuses on the professional aspects of the reviewed firm's accounting and auditing practice and not on the firm's business aspects. The reviewers have no contact with any client. The peer review of a firm with a compilation and review practice is significantly less in scope than the peer review of a firm with an audit practice. Compilation and review-only firms are required to undergo an engagement review, which does not attempt to evaluate the adequacy of the firm's quality control system, even though the firm must maintain a QC system to provide reasonable assurance of complying with professional standards.

106.8 During an engagement review, peer reviewers spend the majority of their time reviewing the required engagement documentation for the type of engagement being examined. If the firm does not regularly possess the required documentation, it can potentially receive a *pass with deficiencies* or *fail* peer review report. The AICPA peer review process is discussed in detail in Chapter 8.

5 Individual CPAs in non-CPA owned firms who perform SSARS compilations under SSARS No. 19 must also be enrolled in a practice monitoring review program, unless the highest level of service they perform is a compilation of management-use-only financial statements not involving issuance of a report. (After implementation of SSARS No. 21, if the highest level of service is financial statement preparation, the firm is not required, but may choose, to be enrolled in peer review.)

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END OF DOCUMENT -

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Checkpoint Contents

Accounting, Audit & Corporate Finance Library

Editorial Materials

Accounting Services

Quality Control—Compilation and Review

Chapter 1 Quality Control—An Overview

107 Organization of This Guide

107 Organization of This *Guide*

107.1 This chapter lays the foundation for the material in the rest of the *Guide*. An overview of information in this chapter is presented in paragraph 100.9. Chapters 2-7 discuss each of the six elements of a firm's system of quality control as required by SQCS No. 8. Those chapters also include information about the requirements of AR-C 60, which is pertinent to quality control for SSARS No. 21 engagements. Chapter 8 discusses participating in the AICPA Peer Review Program under the requirements of the *Standards for Performing and Reporting on Peer Reviews*. The titles of Chapters 2-8 in this *Guide* are listed below.

- Chapter 2—Leadership Responsibilities for Quality Within the Firm.
- Chapter 3—Relevant Ethical Requirements.
- Chapter 4—Acceptance and Continuance of Client Relationships and Specific Engagements.
- Chapter 5—Human Resources.
- Chapter 6—Engagement Performance.
- Chapter 7—Monitoring.

- Chapter 8—The Peer Review Process and Undergoing Engagement Review.

107.2 Included in this *Guide* are almost 50 practice aids to assist firms more efficiently to develop, implement, and maintain their system of quality control. Use of those practice aids is discussed in the relevant chapter and each practice aid includes specific instructions.

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