THOMSON REUTERS
CHECKPOINT™

S. Davis & Associates, P.A.
Certified Public Accountants & Consultants

THE PPC

ACCOUNTING AND AUDITING UPDATE

APRIL 2022, VOLUME 31, NO. 4

Clarified Peer Review Standards Approved

The AICPA Peer Review Board approved *Clarified AICPA Standards for Performing and Reporting on Peer Reviews* in February 2022. The Peer Review Board started this project in 2017.

The proposed clarified standards were developed to make peer review guidance easier to understand and apply, but they don't substantially change current practice, except for reviews of quality control materials (QCM). The Board designed the changes to permit more peer review procedures to be performed in a remote work environment and to reflect increased use of modern technology and paperless environments.

The most significant changes included in the final standards are as follows.

System Reviews

The requirement that most procedures be performed at the office of the reviewed firm was removed. Peer reviewers can now decide where they perform the procedures, and whether to perform any onsite procedures at the reviewed firm's office, based on their assessment of peer review risk.

The requirement for onsite office visits was modified to remove the requirement that firms visit a "sufficient number of offices" in a review of a multi-office firm. Instead, peer reviewers will now determine the number of offices to visit based on their assessment of peer review risk.

The requirement for surprise engagements (providing the engagement selection to the reviewed firm upon arrival at the firm's office) was removed. The reason for this change is consistent with changes to other requirements addressing where procedures are performed. Peer reviewers can now decide whether to include surprise engagements based on their assessment of peer review risk.

Engagement Reviews

The concept of "significant deficiency" in reports with a peer review rating of "fail" was removed. Existing guidance for "fail" refers to deficiencies being present on all reviewed engagements but doesn't address how severe the deficiencies are. Under the clarified standards, reports will only refer to "deficiencies," identify the deficiencies, and won't judge their significance.

In this Issue:

General

The guidance on performing and reporting on reviews of QCM was removed. Providers of QCM may still have their materials examined. However, the examinations will now be done in accordance with AICPA attestation standards.

For single audit engagements, the requirement to include peer review documents in Report Acceptance Board (RAB) meetings was removed. Administering entities may include these documents in RAB meeting materials as a matter of policy, and the RAB may request them when considered necessary. In addition, overall revisions were to make existing peer review guidance easier to read and apply. The manual was reorganized into sections by user (reviewed firms, peer reviewers, or administering entities) and separates requirements from application and explanatory material.

Important Dates

The clarified standards will be effective for peer reviews commencing on or after May 1, 2022. Early implementation isn't permitted.

The final clarified standards and conforming changes to peer review checklists and practice aids will be included in the April 2022 update to the Peer Review Program Manual and on the AICPA Peer Review website. Changes to the PRIMA system will be made to conform the system with the clarified standards.

Practical Consideration:

The AICPA's Special Reviewer Alert - February 2022 is available at **https://us.aicpa.org/content/dam/aicpa/interestareas/peerreview/newsandpublications/downloadabledocuments/reviewer-alert-202202-special.pdf**.

Component Audit Scope and Materiality in Group Audits

Group audits have specific auditing requirements under generally accepted auditing standards. AU-C 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, is the standard that applies. (See the November 2021 article, *Do You Have a Group Audit*?)

Group financial statements include financial information of more than one component. They may include consolidated and combined financial statements and other aggregated financial information, including joint ventures, equity method investments, variable interest entities, branches and divisions, products or services, and locations.

Planning and performing an audit of group financial statements generally involves the same steps, procedures, and decisions as other GAAS audits, but there are special considerations that apply specifically to a group audit.

Determining Group Auditor Involvement

Group auditors are required to obtain sufficient appropriate audit evidence as the basis for the group audit opinion. This evidence includes work performed on the consolidation process and procedures performed by the group engagement team and the component auditors on the financial information of the components. The group auditors will determine the type of work to be performed by the group engagement team or by component auditors on the financial information of the components and the nature, timing, and extent of involvement in the work of component auditors.

The group engagement team establishes the overall audit strategy and audit plan for the group and assesses the extent to which component auditors are used. Individually for each component, the group engagement team may either—

- assume responsibility for the work of a component auditor, or
- not assume responsibility for the work of a component auditor by making reference to them in the group audit report.

Identifying Components

When identifying potential components, auditors consider how the group is structured, along with the nature of the financial information and how it's accumulated and reported. If the operations, management, and financial reporting of a business activity are separate from the group's, it's likely to be a component. This is a matter of professional judgment.

Significant Components

Once components are identified, the components that are of individual financial significance to the group should be identified. The determination of whether a component is significant to the group financial statements is important because greater audit effort needs to be directed to significant components. The professional standards provide limited guidance on how to determine a component's financial significance, so this is an area where auditors will need to apply judgment. Consideration should be given to the most appropriate method or benchmark for the type of entity and specific facts and circumstances.

Components may also be significant based on risks of material misstatement to the group financial statements rather than being financially significant. Components with complex transactions from a business or accounting perspective often may be identified as significant based on risks. Another consideration may be whether the component has significantly higher or lower profitability than expected. For a component that is significant because of its individual financial significance to the group, an audit of the component's financial information using component materiality should be performed.

For a component that is significant not because of its individual financial significance but because it is likely to include significant risks of material misstatement of the group financial statements, one or more of the following should be performed:

- An audit of the component's financial information using component materiality.
- An audit of one or more account balances, classes of transactions, or disclosures relating to the likely significant risks of material misstatement of the group financial statements.
- Specified audit procedures relating to the likely significant risks of material misstatement of the group financial statements.

For components that aren't significant, analytical procedures at the group level should be performed.

Additional Component Testing

If sufficient appropriate audit evidence on which to base the group audit opinion won't be obtained from (1) the work performed on significant components, (2) the work performed on group-wide controls and the consolidation process, and (3) the analytical procedures performed at the group level, additional components that aren't significant should be selected and the group auditor or a component auditor should perform one or more of the following:

- An audit of the component's financial information using component materiality.
- An audit of one or more account balances, classes of transactions, or disclosures.
- A review of the component's financial information using component materiality.
- Specified audit procedures.

The selection of such individual components should be varied over time.

Consolidation Process

The group engagement team should also design and perform audit procedures on the consolidation process, including:

- Performing additional audit procedures to respond to assessed risks of material misstatement of the group financial statements arising from the consolidation process.
- Evaluating whether all components have been included in the group financial statements.
- Evaluating the appropriateness, completeness, and accuracy of consolidation adjustments and reclassifications.
- Evaluating whether any fraud risk factors or indicators of possible management bias exist.
- Determining whether the financial information identified in the component auditor's communication is the information incorporated in the consolidation.
- Determining whether appropriate adjustments have been made when the financial information of a component isn't prepared on the same accounting basis as the group financial statements or when the component has a year-end that differs from the group's year end.

Component Materiality

The determination of component materiality is part of the planning process. Component materiality is determined by the group engagement team for the purposes of the group audit and only needs to be determined for component financial information subject to audit or review.

In a group audit, the engagement team must determine the following:

- Materiality (planning and performance) for the group financial statements as a whole.
- Materiality for particular classes of transactions, account balances, or disclosures in the group financial

The PPC Accounting and Auditing Update is published monthly by Thomson Reuters/ Tax & Accounting, P.O. Box 115008, Carrollton, Texas 75011-5008, (800) 431-9025.

THOMSON REUTERS™

Tax & Accounting - Checkpoint
P.O. Box 115008
Carrollton, Texas 75011-5008
UNITED STATES OF AMERICA

ADDRESS SERVICE REQUESTED

PRSRT STD
U.S. POSTAGE
PAID
Thomson

statements for which there is substantial likelihood that misstatements of lesser amounts than materiality for the group financial statements as a whole would influence a reasonable user's judgment.

- Materiality (planning and performance) for components that will be audited or reviewed by the group engagement team or a component auditor.
- The threshold for clearly trivial misstatements.

The group auditor should determine component materiality for planning purposes for those components on which the group engagement team will perform (or assume responsibility for the work of a component auditor who performs) an audit or review of component financial information. When a separate auditor's report will be issued on the financial statements of a component (regardless of whether reference will be made), it can ordinarily be expected that the materiality amount determined by the component auditor for purposes of the separate report will be acceptable for purposes of the group audit. When reference is to be made to the component auditor, the group auditor isn't required to establish materiality for the component auditor.

AU-C 600 explains that component materiality should be determined taking into account all components, regardless of whether reference is made to a component auditor. AU-C 600 also specifies that—

- Component materiality should be lower than the materiality for the group financial statements as a whole.
- Component performance materiality should be lower than performance materiality for the group financial statements as a whole.
- Different component materiality amounts may be established for different components.
- The aggregate of component materiality may exceed group materiality.

AU-C 600 doesn't provide specific guidance about how to determine component materiality. However, it does say that component materiality, although it may, doesn't need to be determined based on the ratio of each component's benchmark (such as total assets or total revenue) to the group benchmark. In determining component materiality, consideration might be given to the following amounts:

- Group materiality.
- Adjusted group materiality.
- Separate component materiality.

Based on those amounts, and considering the auditor's reporting responsibilities; the number, size, and nature of components; and client expectations, the auditor applies judgment to determine an appropriate amount for component materiality. Group materiality would typically be considered the ceiling for component materiality, and separate component materiality would typically be considered the floor.