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AICPA Professional Standards: Standards for performing and reporting on quality reviews as of June 1, 1992

American Institute of Certified Public Accountants. Quality Review Executive Committee

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AICPA PROFESSIONAL STANDARDS

Volume 2

Accounting & Review Services

Code of Professional Conduct

Bylaws

International Accounting

International Auditing

Consulting Services

Quality Control

Quality Review

Tax Practice

As of June 1, 1992

AICPA

American Institute of Certified Public Accountants

QR Section

STANDARDS FOR PERFORMING AND REPORTING ON QUALITY REVIEWS

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STANDARDS FOR PERFORMING AND REPORTING ON QUALITY REVIEWS

NOTICE TO READERS

Members of the American Institute of Certified Public Accountants who are engaged in the practice of public accounting in the United States or its territories are required to be practicing as proprietors, partners, shareholders, or employees of firms enrolled in an approved practice-monitoring program in order to retain their membership in the Institute beyond specified periods.

The AICPA Board of Directors has established a Quality Review Division within the Institute, which is governed by an executive committee having senior technical committee status with authority to establish and conduct a quality review program in cooperation with state CPA societies that elect to participate.

A firm enrolled in the AICPA quality review program or a member firm of the AICPA division for CPA firms is deemed to be enrolled in an approved practice-monitoring program (an *enrolled firm*). (See sections 2.2.3 and 2.3.4 of the bylaws of the AICPA and the implementing Council resolutions under those sections.)

The Quality Review Executive Committee has issued these standards for performing and reporting on all reviews conducted under the quality review program. These standards are applicable to firms enrolled in that program (the term *firms* includes sole practitioners), to individuals and firms who perform and report on such reviews, to state CPA societies that participate in the administration of the program, to associations of CPA firms that assist their members in arranging and carrying out quality reviews, and to the AICPA Quality Review Division itself.

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QR Section 100

Standards for Performing and Reporting on Quality Reviews

April 1989

Introduction

.01 Quality in the performance of accounting and auditing engagements by AICPA members is the goal of the quality review program. The program seeks to achieve its goal through education and remedial, corrective actions. This goal serves the public interest and, at the same time, enhances the significance of AICPA membership.

.02 Participants in the quality review program need to—

- a. Understand what is necessary for quality practice.
- b. Establish appropriate quality control policies and procedures.
- c. Have an independent review of their accounting and auditing practices at least every three years.¹
- d. Take remedial, corrective actions as needed.

.03 Statement on Quality Control Standards No. 1, *System of Quality Control for a CPA Firm* [QC section 10], issued in November 1979, requires every CPA firm, regardless of its size, to have a system of quality control for its accounting and auditing practice. It identifies nine elements of quality control and states that a firm shall consider each of those elements, to the extent applicable to its practice, in establishing its quality control policies and procedures. In that connection, the statement recognizes that the nature and extent of a firm's quality control policies and procedures depend on a number of factors, such as its size, the degree of operating autonomy allowed its personnel and its practice offices, the nature of its practice, its organization, and appropriate cost-benefit considerations.

.04 The objectives of the quality review program are achieved through the performance of reviews involving procedures tailored to the size of the firm and the nature of its practice. Firms that perform audits of historical or prospective financial statements (*audits* of prospective financial statements are referred to as *examinations* in relevant professional standards) will have on-site reviews, while firms that provide only compilation or review services will have an off-site review of selected reports on those services, unless they elect to have an on-site quality review. Firms enrolled in the program that do not provide those services will not be reviewed.

.05 Upon completing a quality review, the review team prepares a written report and, when applicable in an on-site quality review, a letter of

¹ The initial review under the program will be phased in based on the size of the firm and the nature of its practice over the five-year period from 1989 to 1993. However, firms that perform audits subject to *Government Auditing Standards*, issued by the U.S. General Accounting Office (the "yellow book"), should be aware that they must have "an external quality control review within three years from the effective date of the [GAO] standards," which is January 1, 1989.

comments in accordance with these standards. The reviewed firm transmits these documents and, when applicable, a letter outlining its response to the review team's findings and recommendations to the entity administering its review (a state CPA society or the AICPA Quality Review Division). These documents are not public documents, but the reviewed firm may make them available to the public if it so chooses after they have been formally accepted by the entity administering the review as meeting the requirements of the quality review program.

.06 The program is based on the principle that a systematic monitoring and educational process is the most effective way to attain high-quality performance throughout the profession. Thus, it depends on mutual trust and cooperation. The reviewed firm is expected to take appropriate actions in response to significant deficiencies in its quality controls or in its compliance with them. These actions will be positive and remedial. Disciplinary actions (that is, actions that can result in the termination of a firm's participation in the program and the subsequent loss of membership in the AICPA by its partners or shareholders and its employees) will be taken only for a failure to cooperate or for deficiencies that are so serious that remedial or corrective actions are not suitable.

General Considerations

Enrollment Requirements

.07 At least one of the proprietors, partners, or shareholders of a firm that seeks to be enrolled in the AICPA quality review program must be a member of the AICPA.

Confidentiality

.08 A quality review must be conducted in compliance with the confidentiality requirements set forth in the AICPA Code of Professional Conduct. Information concerning the reviewed firm or any of its clients or personnel, including the findings of the review, that is obtained as a consequence of the review is confidential. Such information should not be disclosed by review team members to anyone not involved in carrying out the review or administering the program or used in any way not related to meeting the objectives of the program.

.09 It is the responsibility of the reviewed firm to take such measures, if any, as may be necessary to satisfy its obligations concerning client confidentiality any time state statutes or ethics rules promulgated by state boards of accountancy do not clearly provide an exemption from confidentiality requirements when quality reviews are undertaken.² In all cases, the reviewed firm may advise its clients that it will have a quality review and that accounting or auditing work for that client may be subject to review.

Independence

.10 Independence must be maintained with respect to the reviewed firm by a reviewing firm, by review team members, and by any other individuals who participate in or are associated with the review. The concepts in the AICPA Code of Professional Conduct should be considered in making independence judgments. In that connection, the specific requirements set forth in Appendix A [paragraph .75] apply.

² The AICPA maintains a list of states, available upon request, that do not clearly provide such an exemption. That list and related guidance material for reviewed firms have been provided to state CPA societies.

Conflict of Interest

.11 A reviewing firm or an individual participating in carrying out or administering a review must not have a conflict of interest with respect to the reviewed firm or those of its clients whose engagements are selected for review. Such firms and individuals should avoid contacts with clients or personnel of the reviewed firm that could be asserted to be evidence of a conflict of interest.

Competence

.12 A review team conducting an on-site quality review must have current knowledge of the type of practice to be reviewed. Individuals reviewing engagements, on-site or off-site, must have a familiarity with the specialized industry practices, such as those found in the banking and insurance industries, of the clients that should be selected for review.

Due Professional Care

.13 Due professional care must be exercised in performing and reporting on the review. This imposes an obligation on all those involved in carrying out the review to fulfill assigned responsibilities in a professional manner similar to that of an independent auditor examining financial statements.

Administration of Reviews

.14 Reviews intended to meet the requirements of the AICPA quality review program must be carried out in conformity with these standards under the supervision of a state CPA society authorized by the AICPA Quality Review Executive Committee to administer quality reviews or under the supervision of the AICPA Quality Review Division. This imposes an obligation on reviewed firms to arrange and schedule their reviews in compliance with the administrative procedures established by those entities, and to cooperate with those entities in all matters related to the review.

Organization of the Review Team

.15 A review team may be formed by a firm engaged by the firm under review (a *firm review*), by a state CPA society participating in the program, or by the AICPA Quality Review Division (a *committee-appointed review team*). Also, the AICPA Quality Review Executive Committee may authorize an association of CPA firms to assist its members by organizing review teams to carry out on-site, but not off-site, quality reviews (an *association review*).

.16 A review team comprises one or more individuals, depending upon the size and nature of the reviewed firm's practice. One member of the review team is designated the team captain. That individual is responsible for organizing and conducting the review, for communicating the review team's findings to the reviewed firm and to the entity administering the review (a participating state CPA society or the AICPA Quality Review Division),³ and for preparing the report and, if applicable, the letter of comments on the review. Team captains on on-site and off-site quality reviews should test the work performed by other reviewers to the extent deemed necessary in the circumstances.

³ The plan of administration adopted by an association of CPA firms that assists its members in arranging and carrying out quality reviews may provide that the association will communicate the review team's findings to the entity administering the review.

Qualifications for Service as a Reviewer

General

.17 Performing and reporting on quality reviews requires the exercise of professional judgment by peers. Accordingly, an individual serving as a reviewer (whether for on-site or off-site quality reviews) must be a member of the AICPA licensed to practice as a certified public accountant and must possess current knowledge of applicable professional standards.

On-Site Quality Reviews

.18 Reviewers participating in on-site quality reviews must be currently active in public practice at a supervisory level in the accounting and auditing function⁴ of a firm enrolled in an approved practice-monitoring program (that is, a firm enrolled in the AICPA quality review program or a firm that is a member of the AICPA Division for CPA firms) as one of the following:

- a. A proprietor, partner, or shareholder
- b. A manager or person with equivalent supervisory responsibilities

All on-site review team members must have at least five years' experience in the practice of public accounting in the accounting and auditing function. A team captain must be a proprietor, partner, or shareholder of an enrolled firm and must have completed a training course that meets requirements established from time to time by the AICPA Quality Review Executive Committee. A team captain must also be associated with a firm that has received an unqualified report on its system of quality control within the previous three years.⁵ A team captain should have a familiarity gained through personal experience with the types of problems encountered by the reviewed firms.

.19 An individual who serves as the team captain for two successive reviews of the same firm may not serve in that capacity for the firm's next quality review.

.20 Where required by the nature of the reviewed firm's practice, individuals with expertise in specialized areas who need not be CPAs may assist the review team in a consulting capacity. For example, computer specialists, statistical sampling specialists, actuaries, or educators expert in continuing professional education may participate in certain segments of the review.

Off-Site Quality Reviews

.21 All reviewers participating in off-site quality reviews (available to firms that perform no audits of historical or prospective financial information) should have had at least five years' experience in the accounting or auditing function⁶ of a firm enrolled in an approved practice-monitoring program⁷ within the most recent ten years, culminating in a position as (1) a proprietor,

⁴ The Quality Review Executive Committee recognizes that practitioners often perform a number of functions, including tax and consulting work, and cannot restrict themselves to accounting and auditing work. This standard is not intended to require that reviewers be individuals who spend all their time on accounting and auditing engagements. However, CPAs who wish to serve as reviewers should carefully consider whether their day-to-day involvement in accounting and auditing work is sufficiently comprehensive to enable them to perform a quality review with professional expertise.

⁵ This provision does not become effective until January 1, 1992, except that if the team captain's firm has had a quality review or a peer review before that date, the report on the review must be unqualified.

⁶ See footnote 4.

⁷ This requirement is applicable only if the reviewer was associated after July 12, 1988, with the firm as a proprietor, partner, or shareholder, or as a manager or person with equivalent supervisory responsibilities.

partner, or shareholder, or (2) a manager or person with equivalent supervisory responsibilities.

Performing On-Site Quality Reviews

Objectives

.22 An on-site quality review is intended to provide the reviewer with a reasonable basis for expressing an opinion on whether during the year under review—

- a. The reviewed firm's system of quality control for its accounting and auditing practice met the objectives of quality control standards established by the AICPA (see Statement on Quality Control Standards No. 1, *System of Quality Control For a CPA Firm*).⁸
- b. The reviewed firm's quality control policies and procedures were being complied with in order to provide the firm with reasonable assurance of conforming with professional standards.

.23 Firms that perform audits of historical or prospective financial statements must have on-site quality reviews because of the public interest in the quality of such audits and the importance to the accounting profession of maintaining the quality of those services.

Basic Requirements

.24 An on-site quality review should include a study and evaluation of the quality control policies and procedures that the reviewed firm had in effect for its accounting and auditing practice during a period of one year mutually agreed upon by the reviewed firm and the team captain. Unless the state CPA society administering the review or the AICPA Quality Review Division, as applicable, agrees to another period because of unusual circumstances, the review year must not end before the end of the previous calendar year.

.25 Statement on Quality Control Standards No. 1 [QC section 10] requires every CPA firm, regardless of its size, to have a system of quality control for its accounting and auditing practice. It states that a firm shall consider each of the following elements of quality control, to the extent applicable to its practice, in establishing its quality control policies and procedures: independence, assigning personnel to engagements, consultation, supervision, hiring, professional development, advancement, acceptance and continuance of clients, and inspection. Accordingly, the review team should obtain a general understanding of the reviewed firm's quality control policies and procedures with respect to each of those nine elements of quality control. Ordinarily, this understanding can be obtained from reading the reviewed firm's responses to a questionnaire developed by the AICPA Quality Review Executive Committee. The review team should also perform appropriate compliance tests related to broad functions.

.26 In smaller firms, senior personnel of the firm are usually directly involved in decisions with respect to assignment of personnel, hiring, advancement, and acceptance and continuance of clients. Various factors inherent in their operations (for example, the limitations imposed by the size of the firm, the relative infrequency of certain events, or the informal, cooperative style of management that might be followed by the firm) may make it efficient and perhaps necessary for senior personnel to make those decisions based on the application of professional judgment in the specific circumstances rather than

⁸ QC section 10.

by the application of previously defined criteria and policies. Similarly, those firms may find that ongoing supervision and monitoring of their practices by senior personnel is an effective way to achieve many of the objectives of a formal inspection program. When those circumstances exist in firms with up to ten professionals (defined as CPAs and those expected to seek that status) during the majority of the review year, the team captain would ordinarily decide to restrict compliance tests of broad functions (for example, tests of administrative and personnel files) to those related to independence, consultation, supervision, and professional development. This would be appropriate when the team captain concludes that the review of selected engagements and interviews with firm personnel will provide an adequate means of identifying failures, if any, to achieve the objectives inherent in the other five elements of quality control.

.27 An on-site quality review should also include—

- a. Review of selected engagements, including the relevant working paper files and reports, with fiscal years ending during the review year—unless a more recent report has been issued—constituting a reasonable cross section of the reviewed firm’s accounting and auditing practice. If the reviewer notes significant deficiencies in the performance of such engagements or the reporting thereon, he or she should identify actions the firm should consider taking to provide the firm with reasonable assurance that such deficiencies will not recur. In that connection, it might be necessary for the reviewer to expand compliance tests of broad functions to identify such actions. In addition, the reviewed firm shall consider whether it is required to take additional actions under relevant professional standards whenever the review team believes that the firm’s report on previously issued financial statements may be inappropriate or that the firm’s work may not support the report issued. In such cases, the reviewed firm shall provide the review team with its conclusions in writing (generally on a “Matter for Further Consideration” form prepared by the reviewer).
- b. Attendance at an exit conference by senior members of the reviewed firm and at least the team captain to discuss the review team’s findings and recommendations and the type of report it will issue.
- c. Preparation of a written report on the results of the review and, if applicable, a letter of comments (see “Reporting on Reviews” [paragraphs .57 through .67]).
- d. Preparation by the reviewed firm, if applicable, of a written response to the letter of comments outlining the actions the firm plans to take with respect to the recommendations made by the review team (see “Reporting on Reviews” [paragraphs .57 through .67]).
- e. Appropriate consideration of the results of the review by a duly constituted committee of a participating state CPA society, or by the AICPA Quality Review Executive Committee or an AICPA committee appointed for that purpose. Such consideration should include, where applicable, an evaluation of the adequacy of the corrective actions the firm has represented it will take and a determination on whether other remedial, corrective actions and/or

monitoring of the firm's action plan should be required (see "Acceptance of Reviews" [paragraphs .68 through .73]).

.28 The AICPA Quality Review Executive Committee has authorized the issuance of programs and checklists, including engagement review checklists, to guide team captains and other members of the review team in carrying out their responsibilities under these standards. Failure to complete all relevant programs and checklists in a professional manner creates the presumption that the review has not been performed in conformity with these standards. Such a review cannot be accepted as meeting the requirements of the quality review program.

Other Requirements

.29 The requirements set forth in the paragraphs that follow supplement the basic requirements set forth above.

Scope of the Review

.30 The review should cover a firm's accounting and auditing practice which, for purposes of quality reviews under these standards, is limited to all auditing, review, and compilation services covered by Statements on Auditing Standards, Statements on Accounting and Review Services, Statements on Standards for Accountants' Services on Prospective Financial Information, and standards for financial and compliance audits contained in *Government Auditing Standards* issued by the U.S. General Accounting Office (the "yellow book").

.31 The review should be directed to the professional aspects of the firm's accounting and auditing practice; it should not include the business aspects of that practice. Moreover, review team members should not have contact with or access to any client of the reviewed firm in connection with the review.

.32 The review team will be provided with basic background information about the reviewed firm by the state CPA society administering the review, the AICPA Quality Review Division, or, where applicable, an authorized association of CPA firms. The review team captain should consider whether to request other useful information from the firm in planning the review. In all cases, the team captain should obtain the reviewed firm's last quality review or peer review report, and, if applicable, the letter of comments and the response thereto, should consider whether the matters discussed require additional emphasis in the current review, and in the course of the review should evaluate the actions of the firm in response to the prior report and letter of comments.

.33 A divestment of a portion of the practice of a reviewed firm during the year under review may have to be reported as a scope limitation if the review team is unable to assess compliance for reports issued under the firm's name during that year. A review team captain who is considering whether a review report should be modified in these circumstances should consult with the entity administering the review.

.34 A reviewed firm may have legitimate reasons for not permitting the working papers for certain engagements to be reviewed. For example, the financial statements of an engagement selected for review may be the subject of litigation or investigation by a government authority, or the firm may have been advised by a client that it will not permit the working papers for its engagement to be reviewed. In such circumstances, the review team should satisfy itself as to the reasonableness of the explanation. Also, in order to reach a conclusion that the excluded engagements do not have to be reported as a

scope limitation, the review team needs to consider the number, size, and relative complexity of the excluded engagements, and should review other engagements in a similar area of practice as well as other work of the supervisory personnel who participated in the excluded engagements.

.35 In reviewing a practice office, the accounting and auditing practice to be reviewed includes reports issued for or to another office of the reviewed firm, a correspondent firm, or an affiliated firm. For those situations in which engagements selected in the practice office being reviewed include use of the work of another office, correspondent, or affiliate, the review team may limit its review to portions of the engagements performed by the practice office being reviewed but should evaluate the appropriateness of the instructions issued by the reviewed office and the adequacy of the procedures followed to comply with professional standards.

Study and Evaluation of Quality Controls

.36 The review team should begin its review by a study and evaluation of the reviewed firm's quality control policies and procedures over its accounting and auditing practice in relation to the guidance material contained in *Quality Control Policies and Procedures for CPA Firms, Establishing Quality Control Policies and Procedures*,⁹ and in the program for reviewers issued by the AICPA Quality Review Executive Committee. As previously stated, team captains on reviews of firms with up to ten professionals would ordinarily restrict compliance tests of broad functions to those related to the quality control elements of independence, consultation, supervision, and professional development. This study and evaluation, which should be continuously reevaluated during the course of the review, assists the review team in deciding whether the reviewed firm has adopted appropriately comprehensive and suitably designed policies and procedures that are relevant to the size and nature of its practice.

Extent of Compliance Tests

.37 Based on its consideration of the background information provided by the firm, including the results of the firm's last quality review or peer review, and on its study and evaluation of the reviewed firm's quality control policies and procedures, the review team should consider whether any modifications to the programs and checklists issued by the AICPA Quality Review Executive Committee are appropriate. The team captain should then develop a general plan for the conduct of the review, including the nature and extent of compliance tests. The compliance tests should be tailored to the practice of the reviewed firm and, taken as a whole, should be sufficiently comprehensive to provide a reasonable basis for concluding whether the reviewed firm's quality control policies and procedures were complied with to provide the firm with reasonable assurance of conforming with professional standards in the conduct of its accounting and auditing practice. Such tests should be performed at the practice office(s) visited and should relate either to broad functions or to individual engagements. The tests should include—

- a. Review of selected engagements, including working paper files and reports, to evaluate their conformity with professional standards and compliance with relevant firm quality control policies and procedures in their conduct.
- b. Interviews with firm professional personnel at various levels and, if applicable, other persons responsible for a function or activity, to

⁹ QC section 90.

assess their understanding of and compliance with the firm's quality control policies and procedures.

- c. Obtaining other evidential matter as appropriate, for example, by review of selected administrative or personnel files, correspondence files documenting consultations on technical or ethical questions, files evidencing compliance with continuing professional education requirements, and the firm's library.

Selection of Offices

.38 The process of office selection in a multi-office firm involves the exercise of considerable professional judgment. Visits to practice offices should be sufficient to enable the review team to evaluate whether the firm's quality control policies and procedures are adequately communicated throughout the firm and whether they are being complied with. Accordingly, the practice offices visited should provide a reasonable cross section of the reviewed firm's accounting and auditing practice and the office selection process should include consideration of the following factors:

- a. Number, size, and geographic distribution of offices
- b. The degree of centralization of accounting and auditing practice control and supervision
- c. The review team's evaluation, where applicable, of the firm's inspection program
- d. Recently merged or recently opened offices
- e. The significance of industry concentrations (including concentrations of engagements in high-risk industries) and of specialty practice areas, such as governmental compliance audits or regulated industries, to the firm and to individual offices

.39 Although the process of office selection is not subject to definitive criteria, a review team should select at least one of the larger offices and one to three others in a multi-office firm with up to fifteen offices and 15 to 25 percent of the offices in a firm with more than fifteen offices.

.40 Reviewers should ask the entity administering the review about any requirements of relevant state boards of accountancy that must be met for the review to be accepted by such board(s) as the equivalent of one performed under the board's own positive enforcement program.

Selection of Engagements

.41 When combined with other procedures performed, the number and type of accounting and auditing engagements selected by the review teams for review (see "Scope of the Review" [paragraphs .30 through .35]) should be sufficient to provide the review team with a reasonable basis for its conclusions regarding whether the reviewed firm's quality control system met the objectives of quality control standards established by the AICPA and was being complied with during the year under review.

.42 Engagements selected for review should provide a reasonable cross section of the reviewed firm's accounting and auditing practice. However, the number of review and compilation engagements selected for review may be significantly limited when a substantial portion of the firm's accounting and auditing hours are devoted to audit engagements. Also, greater weight should be given to audit engagements that meet the following criteria:

- a. Engagements in which there is a significant public interest, such as publicly held clients, financial and lending institutions, and brokers and dealers in securities
- b. Engagements in other specialized industries
- c. Engagements that are large, complex, or high-risk or that are the reviewed firm's initial audits of clients

In addition, the sample of engagements selected for review should include at least one audit conducted pursuant to *Government Auditing Standards* issued by the U.S. General Accounting Office (the "yellow book").

.43 Although the process of engagement selection, like office selection, is not subject to definitive criteria, the review team generally should review work that represents 5 to 10 percent of the accounting and auditing hours of the reviewed firm. However, the review team will frequently find that meeting all of the criteria discussed above would cause it to select engagements representing accounting and auditing hours substantially in excess of these percentage guidelines. In such circumstances, the review team should carefully consider whether—

- a. Adequate consideration has been given to the *key audit area* approach to engagement review. (This is discussed more fully in the AICPA programs and checklists.)
- b. Too much weight is being given to the desirability of reviewing work performed by all or most supervisory personnel.
- c. Adequate consideration has been given to engagement selection on a firm-wide basis. For example, if two offices are selected for review and each has a large client in the same specialized industry, consideration should be given to selecting only one of those engagements for review.

Extent of Engagement Review

.44 The review of engagements should include review of financial statements, accountants' reports, working paper files, and correspondence, as well as discussions with professional personnel of the reviewed firm. The review of audit engagements should ordinarily include all key areas of the engagements selected to determine whether well-planned, appropriately executed, and suitably documented procedures were performed in accordance with professional standards and the reviewed firm's quality control policies and procedures.

.45 For each engagement reviewed (audits, reviews, and compilations), the review team must document whether anything came to its attention that caused it to believe that—

- a. The financial statements were not presented in all material respects in accordance with generally accepted accounting principles (or, if applicable, an other comprehensive basis of accounting).
- b. The firm did not have a reasonable basis under applicable professional standards for the report issued.
- c. The documentation on the engagement did not support the report issued.
- d. The firm did not comply with its quality control policies and procedures in all material respects.

.46 If the review team reaches a negative conclusion with respect to items *a*, *b*, or *c*, the team captain should promptly inform an appropriate member of the reviewed firm (generally on a "Matter for Further Consideration" form).

The reviewed firm should investigate the matter questioned by the review team and determine what action, if any, should be taken. The reviewed firm should advise the team captain of the results of its investigation and document the actions taken or planned or its reasons for concluding that no action is required. If the reviewed firm believes that it can continue to support its previously issued report and the review team continues to believe that there may be a significant failure to reach appropriate conclusions in the application of professional standards, the review team should pursue any remaining questions with the reviewed firm and, if necessary, with the entity administering the review. The review team should also consider whether it is necessary to expand the scope of the review by selecting additional engagements to determine the extent and cause of significant departures from professional standards.

.47 In evaluating the reviewed firm's response, the review team should recognize that it has not made an examination of the financial statements in question in accordance with generally accepted auditing standards and that it has not had the benefit of access to client records, discussions with the client, or specific knowledge of the client's business. Nevertheless, a disagreement on the resolution of the matter may persist in some circumstances and the reviewed firm should be aware that it may be requested to refer unresolved matters to the AICPA Quality Review Executive Committee for a final determination.

Exit Conference

.48 Prior to issuing its report and, if applicable, letter of comments, the review team must communicate its conclusions to senior members of the reviewed firm at an exit conference, which may also be attended by individual(s) with oversight responsibilities. The reviewed firm is entitled to be informed at the exit conference about any matters that may affect the review report and about all significant findings and recommendations that will be included in the letter of comments. Accordingly, except in rare circumstances which should be explained to the reviewed firm, the exit conference should be postponed if there is any uncertainty about the report to be issued or the matters to be included in the letter of comments. The exit conference is also the appropriate vehicle for providing suggestions to the firm that do not have an effect on the report or letter of comments.

Performing Off-Site Quality Reviews

Objectives

.49 The objective of an off-site quality review is to provide the reviewer with a reasonable basis for expressing limited assurance that the financial statements and related accountant's report on the review and compilation engagements submitted for review do not depart in a material respect from the requirements of professional standards. This objective is different from the objectives of an on-site quality review in recognition of the fact that off-site quality reviews are available only to firms that perform review or compilation engagements but perform no audits of historical or prospective financial information. An accountant's review report clearly expresses only limited assurance about the financial statements, and an accountant's compilation report states that the accountant expresses no opinion or other form of assurance on the historical or prospective financial statements. Such firms will only be required to have an off-site quality review unless they elect to have an on-site quality review. However, this does not relieve such firms from their obligation to have a system of quality control (see paragraph .03).

Basic Requirements

.50 Off-site quality reviews are administered only by participating state CPA societies or by the AICPA Quality Review Division. Associations of CPA firms are not authorized to arrange or carry out off-site quality reviews. Also, compliance with the positive enforcement program of a state board of accountancy does not constitute compliance with the AICPA practice-monitoring requirement.

.51 The reviewed firm shall provide summarized information showing the number of its review or compilation clients and the nature of the highest level of service provided to those clients, classified into major industry categories. That information shall be provided for each proprietor, partner, or shareholder of the firm who is responsible for the issuance of review or compilation reports. On the basis of that information, the reviewer or the entity administering the review shall select the types of engagements to be submitted for review, in accordance with the following guidelines:

- a. Select one review or compilation engagement involving a report on a complete set of financial statements as opposed to compilation reports on financial statements that omit substantially all of the disclosures required by generally accepted accounting principles or an other comprehensive basis of accounting, for each proprietor, partner, or shareholder responsible for the issuance of such reports. However, at least two engagements must be selected for the firm.
- b. In selecting engagements for review, include both review and compilation engagements, if both levels of service are provided. Also, attempt to include clients operating in different industries and engagements involving prospective financial statements as well as those involving historical financial statements.
- c. In addition to the selection made in *a*, select, where applicable, one set of financial statements that omit substantially all of the disclosures required by generally accepted accounting principles or an other comprehensive basis of accounting and the related accountant's compilation report. However, if the firm's accounting practice consists only of compilation reports on financial statements that omit substantially all required disclosures, the firm must submit the financial statements and related accountant's report for two such engagements.

The reviewed firm shall submit the appropriate financial statements and accountant's report, masking client identity if it desires, along with specified background information and representations about each engagement.

.52 An off-site quality review consists only of reading the historical or prospective financial statements submitted by the reviewed firm and the accountant's review or compilation report thereon, together with certain background information and representations provided by the reviewed firm. The objective of the review of these engagements is to consider whether the financial statements appear to be in conformity with generally accepted accounting principles or, if applicable, with an other comprehensive basis of accounting, and whether the accountant's report appears to conform with professional standards. An off-site quality review does not include a review of the working papers prepared on the engagements submitted for review, tests of the firm's administrative or personnel files, interviews of selected firm personnel, or other procedures performed in an on-site quality review.

.53 Accordingly, an off-site quality review does not provide the reviewer with a basis for expressing any form of assurance on the firm's quality control policies and procedures for its accounting practice. The reviewer's report does indicate, however, whether anything came to the reviewer's attention that caused him or her to believe that the review and compilation reports submitted for review did not conform with the requirements of professional standards.

.54 A firm that has an off-site quality review must respond promptly to questions raised in the review, whether those questions are raised orally or in writing on a "Matter for Further Consideration" form. The reviewer will contact the firm, before issuing the review report, to resolve questions raised in the review.

.55 Although an off-site quality review does not provide the reviewer with a basis for expressing any form of assurance on the firm's quality control policies and procedures for its accounting practice, it may provide the reviewer with a basis for expressing a conclusion that the firm did not have reasonable assurance of conforming with professional standards in the conduct of its accounting practice during the year under review (an adverse report). In those circumstances, the reviewed firm will be expected to take appropriate remedial, corrective actions with respect to its system of quality control and with respect to engagements with significant deficiencies. In addition, it will ordinarily be required to have another off-site quality review within twelve months.

.56 The reviewer performing an off-site quality review must document the work performed using the programs and checklists issued by the AICPA Quality Review Executive Committee for that purpose. Failure to complete all relevant programs and checklists in a professional manner creates the presumption that the review has not been performed in conformity with these standards. Such a review cannot be accepted as meeting the requirements of the quality review program.

Reporting on Reviews

General

.57 Within thirty days of the date of the exit conference or the date of completion of an off-site quality review, the team captain should furnish the reviewed firm with a written report and, where required, a letter of comments. A report on a review performed by a firm is to be issued on the letterhead of the firm performing the review. A report by a review team formed by an association of CPA firms is to be issued on the association's letterhead. All other reports are to be issued on the letterhead of the entity administering the review, which may be a state CPA society or the AICPA Quality Review Division. The report on an on-site quality review ordinarily should be dated as of the date of the exit conference. The report on an off-site quality review ordinarily should be dated as of the completion of the review procedures.

.58 The team captain or, where provided by its plan of administration, an authorized association of CPA firms should notify the entity administering the review that the review has been completed and should submit to that entity a copy of the report and letter of comments, if any, and the working papers specified in the programs and checklists issued by the AICPA Quality Review Executive Committee.

.59 The reviewed firm should submit a copy of the report, the letter of comments, if any, and its response to all matters discussed in the report or

letter of comments to the entity administering the review within thirty days of the date it received the report and letter.

.60 The reviewed firm should not publicize the results of the review or distribute copies of the report to its personnel, its clients, or others until it has been advised that the report has been accepted by the state CPA society administering the review or by the AICPA Quality Review Division as meeting the requirements of the quality review program. Those entities may not make the results of the review available to the public, but may disclose on request the following information:

- a. The firm's name and address
- b. The firm's participation in the quality review program
- c. The date of, and the period covered by, the firm's last review
- d. If applicable, the termination of the firm from the program

Reports on On-Site Quality Reviews

.61 The written report on an on-site quality review should indicate the scope of the review, including any limitations thereon; a description of the general characteristics of a system of quality control; an opinion on whether the system of quality control for the accounting and auditing practice of the reviewed firm met the objectives of quality control standards established by the AICPA and was being complied with during the year reviewed to provide the firm with reasonable assurance of conforming with professional standards; and a description of the reason(s) for any modification of the opinion.

.62 A team captain may issue an unqualified, qualified, or adverse report on the review. In deciding on the type of report to be issued, the team captain should be guided by the considerations discussed in Appendix B [paragraph .76]. The standard form of unqualified report is illustrated in Appendix C [paragraph .77]. Illustrations of qualified and adverse reports are presented in Appendix D [paragraph .78].

Reports on Off-Site Quality Reviews

.63 The written report on an off-site quality review should describe the limited scope of the review and disclaim an opinion or any form of assurance about the firm's quality control policies and procedures for its accounting practice; indicate whether anything came to the reviewer's attention that caused the reviewer to believe that the review and/or compilation reports submitted for review did not conform with the requirements of professional standards in all material respects; and, if applicable, describe the general nature of significant departures from those standards. The report should also, where applicable, include the reviewer's conclusion that the firm did not have reasonable assurance of conforming with professional standards in the conduct of its accounting practice during the year under review.

.64 In deciding on the type of report to be issued, the team captain should be guided by the considerations in Appendix G [paragraph .81]. The standard form for an unmodified report on an off-site quality review is illustrated in Appendix H [paragraph .82]. Illustrations of other types of reports are presented in Appendix I [paragraph .83]. Appendix J [paragraph .84] includes an illustration of the way in which a firm might respond to a modified review report.

Letters of Comments

.65 A letter of comments is required to be issued in connection with an on-site quality review when there are matters that resulted in modification(s) to

the standard form of report or when there are matters that the review team believes resulted in conditions being created in which there was more than a remote possibility that the firm would not conform with professional standards on accounting and auditing engagements. Such a letter should provide reasonably detailed recommendations for remedial, corrective actions by the reviewed firm so that the state CPA society administering the review or the AICPA Quality Review Division can evaluate whether the firm's response to significant deficiencies noted in the review is a positive one consistent with the objectives of the quality review program and whether the actions taken or planned by the firm appear appropriate in the circumstances.

.66 The letter of comments should be prepared in accordance with the guidance and illustrations in Appendix E [paragraph .79]. An illustration of a response by a reviewed firm is included in Appendix F [paragraph .80].

.67 When a letter of comments is issued along with a qualified or adverse report, the report on the review must make reference to the letter. No reference should be made to the letter of comments in an unqualified report.

Acceptance of Reviews

.68 A committee or committees should be appointed by each participating state CPA society and by the AICPA for the purpose of considering the results of reviews administered by them and undertaken to meet the requirements of the quality review program. The activities of such committees (hereafter, the *committee*) should be carried out in accordance with administrative procedures issued by the AICPA Quality Review Executive Committee.

.69 The committee's responsibility is to consider whether—

- a. The review has been performed in accordance with these standards and related guidance materials.
- b. The report, letter of comments, if any, and the response thereto are in accordance with these standards and related guidance material.
- c. It should require any remedial, corrective actions in addition to those described by the reviewed firm in its letter of response. Examples of such corrective actions are requiring certain individual(s) to obtain specified types and amounts of continuing professional education, requiring the firm to carry out a more comprehensive inspection program, or requiring it to engage another CPA to perform preissuance reviews of financial statements and reports, or to attempt to strengthen its professional staff.
- d. It should monitor the corrective actions implemented by the reviewed firm. Examples of monitoring procedures are requiring the firm to submit information concerning continuing professional education obtained by firm personnel, inspection reports, or reports by another CPA engaged to perform preissuance reviews of financial statements and reports. Revisits by team captains and accelerated quality reviews are other examples of monitoring procedures.

.70 If no additional corrective actions are deemed necessary, the committee will accept the report and so notify the reviewed firm. If additional actions by the reviewed firm or if monitoring procedures are deemed necessary, the firm will be required to evidence its agreement in writing before the report is accepted.

.71 In the rare event of a disagreement between the committee and the review team or the reviewed firm that cannot be resolved by ordinary good-

faith efforts, the committee may request that the matter be referred to the AICPA Quality Review Executive Committee for final resolution. In these circumstances, the AICPA Quality Review Executive Committee may consult with representatives of AICPA technical or ethical committees or with appropriate AICPA staff.

.72 In reaching its conclusions, the committee is authorized to make whatever inquiries or initiate whatever actions it considers necessary in the circumstances, including requesting revision of the report, the letter of comments, or the reviewed firm's response, with due regard for the fact that the quality review program is intended to be positive and remedial in nature, and is based on mutual trust and cooperation. Accordingly, in deciding on the need for and nature of any additional corrective actions or monitoring procedures, the committee should consider the nature, significance, pattern, and pervasiveness of engagement deficiencies. It should evaluate whether the recommendations of the review team appear to address those deficiencies adequately and whether the reviewed firm's responses to those recommendations appear comprehensive, genuine, and feasible. In a subsequent review, its conclusions should be significantly influenced by a finding that the reviewed firm did not adequately implement significant corrective actions it had represented it would take and by the committee's assessment of the reason for such a failure. If such a failure continues despite requirements for corrective actions and appropriate monitoring, the committee should consider whether requirements for remedial, corrective actions are adequate responses to the situation.

.73 If a reviewed firm refuses to cooperate, fails to correct material deficiencies, or is found to be so seriously deficient in its performance that education and remedial, corrective actions are not adequate, the AICPA Quality Review Executive Committee may take actions, pursuant to due process procedures that it will establish, leading to the termination of the firm from the quality review program. However, if a decision is made to terminate a firm's enrollment, the firm will have the right to appeal to the AICPA Joint Trial Board for a review of the findings. The trial board will have the authority to confirm or to reduce the severity of the findings, but it will not have the authority to increase their severity. The fact that a firm's enrollment in the quality review program has been terminated shall be reported in an AICPA membership periodical.

Qualifications of Committee Members

.74 Each member of a committee charged with the responsibility for acceptance of reviews must be currently active in public practice at a supervisory level in the accounting or auditing function of a firm enrolled in an approved practice-monitoring program as a proprietor, partner, shareholder, or as a manager or person with equivalent supervisory responsibilities. A majority of the members must also possess the qualifications required of on-site quality review team captains. A member may not participate in any discussion or have any vote with respect to a reviewed firm as to which the member lacks independence or has a conflict of interest.

Appendix A

.75

Independence Requirements

Reciprocal Reviews

1. Reciprocal reviews are not permitted. This means that a firm may not perform a review of the firm that performed its most recent quality review or peer review. It also means that no professional may serve on a review team carrying out a review of a firm whose professional personnel participated in the most recent review of that professional's firm.

Relationships With Clients of the Reviewed Firm

2. Review team members and, in the case of a review performed by a firm, the reviewing firm and its personnel are not precluded from owning securities in or having family or other relationships with clients of the reviewed firm. However, a review team member who owns securities of a reviewed firm's client shall not review the engagement of that client, since that individual's independence would be considered to be impaired. In addition, the effect on independence of family and other relationships and the possible resulting loss of the appearance of independence must be considered when assigning team members to engagements.

Relationships With the Reviewed Firm

3. Reviewing firms should consider any family or other relationships between the senior managements at organizational and functional levels of the reviewing firm and the firm to be reviewed and should assess the possibility of an impairment of independence.

4. If the fees for correspondent work, whether paid by the referring firm or by the client, involving the reviewed firm and the reviewing firm or the firm of any member of the review team, are material to any of those firms, independence for the purposes of this program is impaired.

5. If continuing arrangements exist between the reviewed firm and the reviewing firm or the firm of any member of the review team whereby fees, office facilities, or professional staff are shared, independence for the purposes of this program is impaired. Similarly, independence would be considered to be impaired by sharing arrangements involving, for example, frequent continuing education programs, extensive consultation, preissuance reviews of financial statements and reports, and audit and accounting manuals. In such circumstances, the firms involved are sharing materials and services that are an integral part of their quality control systems. However, the impairment would be removed if an independent review was made of the shared materials (such as continuing education programs or an audit and accounting manual) before the quality review commenced and that independent review was accepted by the AICPA Quality Review Executive Committee or the relevant state CPA society (or by a peer review committee of the AICPA Division for CPA Firms) before that date. (Firms that share materials and services are advised to consult with the AICPA Quality Review Division if an independent review of such shared materials and services appears necessary.) Also, independence for the purposes of this program is not impaired by the performance of a review of a firm's quality control document, of a preliminary quality control procedures review or *consulting review*, or an inspection.

Appendix B

.76

Considerations Governing the Type of Report Issued on an On-Site Quality Review

Limitation on Scope of Review

1. A modified report should be issued when the scope of the review is limited by conditions that preclude the application of one or more review procedures considered necessary in the circumstances and the review team cannot accomplish the objectives of those procedures through alternate procedures. For example, as indicated in the Standards, a review team may be able to apply appropriate alternate procedures when one or more engagements have been excluded from the scope of the review for legitimate reasons but ordinarily would be unable to apply alternate procedures when a significant portion of the firm's accounting and auditing practice during the year reviewed had been divested before the review began. A review team captain who is considering modifying the review report for a scope limitation should consult with the entity administering the review.

The Nature and Significance of Engagement Deficiencies

2. The overriding objective of a system of quality control is to provide the firm with reasonable assurance of conforming with professional standards in the conduct of its accounting and auditing practice. When a review team encounters significant failures to reach appropriate conclusions, particularly those requiring the application of AU section 390, *Consideration of Omitted Procedures After the Report Date*, or AU section 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report*, the team is faced with a clear indication that, in those engagements, the firm did not comply with professional standards. The review team's first task in such circumstances is to try to determine why the failure occurred. The cause of the failure to reach appropriate conclusions might be systems-related and might affect the type of report issued when, for example—

- a. The failure related to a specialized industry practice and the firm had no experience in that industry and made no attempt to acquire training in the industry or to obtain appropriate consultation and assistance.
- b. The failure related to a matter covered by a recent professional pronouncement and the firm had failed to identify through professional development programs or appropriate supervision the relevance of that pronouncement to its practice.
- c. The failure should have been detected if the firm's quality control policies and procedures had been followed.
- d. The failure should have been detected by the application of quality control policies and procedures commonly found in firms similar in size or nature of practice. That judgment can often be made by the reviewer based on personal experience or knowledge; in some cases, the reviewer will wish to consult with the entity administering the review before reaching such a conclusion.

3. The failure to reach appropriate conclusions on an engagement may be the result of an isolated human error and, therefore, does not necessarily mean that the review report should be modified. However, when the reviewer

believes that the probable cause (for example, a failure to provide or follow appropriate policies for supervision of the work of assistants) of a significant failure to reach appropriate accounting and auditing conclusions on one engagement also exists in other engagements, even though no significant deficiencies were noted in those engagements, the reviewer needs to consider carefully the need for a qualified or adverse report.

The Pattern and Pervasiveness of Engagement Deficiencies

4. The review team must consider the pattern and pervasiveness of engagement deficiencies and their implications for compliance with the firm's system of quality control as a whole, in addition to their nature and significance in the specific circumstances in which they were observed. As in the preceding section, the review team's first task is to try to determine why the deficiencies occurred. In some cases, the design of the firm's system of quality control may be deficient as, for example, when it does not provide for timely partner involvement in the planning process. In other cases, there may be a pattern of noncompliance with a quality control policy or procedure as, for example, when firm policy requires the completion of a financial statement disclosure checklist but such checklists often were used only as a reference and not filled out. That, of course, makes effective partner review more difficult and increases the possibility that the firm might not comply with professional standards in a significant respect. On the other hand, the types of deficiencies noted may be individually different, not individually significant, and not directly traceable to the design of or compliance with a particular quality control policy or procedure. This may lead the reviewer to the conclusion that the deficiencies were isolated cases of human error.

Design Deficiencies

5. There may be circumstances when the reviewer finds few deficiencies in the work performed by the firm and yet may conclude that the design of the firm's quality control system needs to be improved. For example, a firm that is growing rapidly and adding personnel and clients may not be giving appropriate attention to necessary policies and procedures in areas such as hiring, assigning personnel to engagements, advancement, and client acceptance and continuance. A reviewer might conclude that these conditions could create a situation in which the firm would not have reasonable assurance of conforming with professional standards in one or more important respects. However, in the absence of deficiencies in the engagements reviewed, the reviewer would ordinarily conclude that the matter should be dealt with in the letter of comments.

* * * *

6. In order to give appropriate consideration to the evidence obtained and to form appropriate conclusions, the review team must understand the elements of quality control and exercise professional judgment. The exercise of professional judgment is essential because the significance of the evidence obtained cannot be evaluated primarily on a quantitative basis.

Appendix C

.77

Standard Form for an Unqualified Report on an On-Site Quality Review

[AICPA or State Society letterhead for a "CART Review"; Firm letterhead for a "Firm Review"; Association letterhead for an "Association Review"]

August 31, 19XX

To the Partners
Able, Baker & Co.

or

To John B. Able, CPA

We have reviewed the system of quality control for the accounting and auditing practice of [*Name of Firm*] (the firm) in effect for the year ended June 30, 19XX. Our review was conducted in conformity with standards for on-site quality reviews established by the American Institute of Certified Public Accountants. We tested compliance with the firm's quality control policies and procedures to the extent we considered appropriate. These tests included a review of selected accounting and auditing engagements.

In performing our review, we have given consideration to the quality control standards issued by the AICPA. Those standards indicate that a firm's system of quality control should be appropriately comprehensive and suitably designed in relation to the firm's size, organizational structure, operating policies, and the nature of its practice. They state that variance in individual performance can affect the degree of compliance with a firm's quality control system and, therefore, recognize that there may not be adherence to all policies and procedures in every case.

In our opinion, the system of quality control for the accounting and auditing practice of [*Name of Firm*] in effect for the year ended June 30, 19XX, met the objectives of quality control standards established by the AICPA and was being complied with during the year then ended to provide the firm with reasonable assurance of conforming with professional standards in the conduct of that practice.

John Brown, Team Captain
[or *Name of Reviewing Firm*]

Appendix D

.78

Illustrations of Qualified and Adverse Reports on an On-Site Quality Review

Report Qualified for Design Deficiency

[Separate paragraph after the standard first two paragraphs]

As discussed in our letter of comments under this date, our review disclosed that the firm's quality control policies and procedures for supervision regarding audit planning were not appropriately designed to provide the firm with reasonable assurance of conforming with professional standards.

[Opinion paragraph]

In our opinion, except for the deficiency described in the preceding paragraph, the system of quality control. . . .

Report Qualified for Noncompliance

[Separate paragraph after the standard first two paragraphs]

As discussed in our letter of comments under this date, our review disclosed that the firm's quality control policies and procedures for supervision regarding completion of financial statement reporting and disclosure checklists were not followed in a manner to provide the firm with reasonable assurance of conforming with professional standards.

[Opinion paragraph]

In our opinion, except for the deficiency described in the preceding paragraph, the system of quality control. . . .

Adverse Report

[Separate paragraph after the standard first two paragraphs]

As discussed in our letter of comments under this date, our review disclosed several failures to adhere to professional standards in reporting on material departures from generally accepted accounting principles, in applying other generally accepted auditing standards, and in complying with the standards for accounting and review services. In that connection, our review disclosed that the firm's quality control policies and procedures were not appropriately designed because they do not require the preparation of a written audit program, which is required by generally accepted auditing standards. In addition, our review disclosed failures to complete financial statement reporting and disclosure checklists required by firm policy and failures to review engagement working papers in the manner required by firm policy.

[Opinion paragraph]

In our opinion, because of the significance of the matters discussed in the preceding paragraph, the system of quality control for the accounting and auditing practice of [*Name of Firm*] in effect for the year ended June 30, 19XX, did not meet the objectives of quality control standards established by the AICPA (, was not being complied with during the year then ended [*include when there are compliance as well as design deficiencies*]) and did not provide the firm with reasonable assurance of conforming with professional standards in the conduct of that practice.

Appendix E

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Guidelines for and Illustration of a Letter of Comments on an On-Site Quality Review

Guidelines

1. The objectives of the letter of comments on an on-site quality review are set forth in the Standards. Such letters are expected to be issued on most on-site reviews.

2. The letter should be addressed, dated, and signed in the same manner as the report on the on-site quality review, and should include—

- a. A reference to the report on the review, indicating, where applicable, that the report was qualified or adverse.
- b. A description of the purpose of the on-site quality review.
- c. A statement that the review was performed in accordance with standards established by the AICPA.
- d. A description of the limitations of a system of quality control.
- e. The findings on the review and related recommendations. (This section should be separated between those findings, if any, that resulted in a modified report and those that did not. In addition, the letter should identify, where applicable, any comments that were also made in the letter of comments issued on the firm's previous on-site quality review or peer review.)
- f. A statement that the matters discussed in the letter were considered in determining the opinion on the system of quality control.

3. In addition to matters that resulted in a modified report, which must always be included in the letter, the letter of comments should include, according to the Standards, "matters that the review team believes resulted in conditions being created in which there was more than a remote possibility that the firm would not conform with professional standards on accounting and auditing engagements." The letter should include comments on such matters even if they did not result in deficiencies on the engagements reviewed. When engagement deficiencies, particularly instances of nonconformity with professional standards, were attributable to deficiencies in the design of the firm's system of quality control or noncompliance with significant firm policies and procedures that are included in the letter, that fact should be noted in the comment.

4. Although isolated instances of noncompliance with the firm's quality control policies and procedures ordinarily would not be included in a letter of comments, their nature, importance, causes (if determinable), and implications for the firm's quality control system as a whole should be evaluated in conjunction with the review team's other findings before making a final determination.

Illustration of a Letter of Comments

[AICPA or State Society letterhead for a "CART Review"; Firm letterhead for a "Firm Review"; Association letterhead for an "Association Review"]

August 31, 19XX

To the Partners
Able, Baker & Co.
or
To John B. Able, CPA

We have reviewed the system of quality control for the accounting and auditing practice of [Name of Firm] (the firm) in effect for the year ended June 30, 19XX, and have issued our report thereon dated August 31, 19XX (, which was modified as described therein). This letter should be read in conjunction with that report.

Our review was for the purpose of reporting upon the firm's system of quality control and its compliance with that system. Our review was performed in accordance with standards for on-site quality reviews established by the American Institute of Certified Public Accountants; however, our review would not necessarily disclose all weaknesses in the system or all instances of noncompliance with it because our review was based on selective tests.

There are inherent limitations that should be recognized in considering the potential effectiveness of any system of quality control. In the performance of most control procedures, departures can result from misunderstanding of instructions, mistakes of judgment, carelessness, or other personal factors. Projection of any evaluation of a system of quality control to future periods is subject to the risk that the procedure may become inadequate because of changes in conditions or that the degree of compliance with the procedure may deteriorate.

Matters That Resulted in a Modified Report *

Finding—The firm's quality control policies and procedures do not require partner involvement in the planning stage of audit engagements. Generally accepted auditing standards permit the auditor with final responsibility for the engagement to delegate some of this work to assistants, but emphasize the importance of proper planning to the conduct of the engagement. We found one engagement in which, as a result of a lack of involvement, including timely supervision, by the engagement partner in planning the audit, the work performed on receivables and inventory did not appear to support the firm's opinion on the financial statements. (As a result of this finding, the firm performed the necessary additional procedures to provide a satisfactory basis for its opinion.)

Recommendation—The firm's quality control policies and procedures should be revised to provide, at a minimum, for timely audit partner review of the preliminary audit plan and the audit program.

Matters That Did Not Result in a Modified Report *

Finding—Our review disclosed several engagements for which financial statement disclosures were missing or incomplete. None of the missing or incomplete disclosures represented significant departures from professional

* Include these captions only when the report is modified.

standards, but in each case we noted that the firm had not complied with its policy requiring completion of a financial reporting and disclosure checklist.

Recommendation—The firm should comply with its policy requiring completion of its financial reporting and disclosure checklist. We recommend that the firm emphasize the importance of this policy to all personnel in its training sessions.

Finding—Our review disclosed that the firm's reference library contains outdated editions of industry audit and accounting guides for industries in which some of the firm's clients operate. As a result, we found a few instances where financial statement formats departed, although not in material respects, from current practice.

Recommendation—The firm should assign the responsibility for ensuring that the library is comprehensive and up to date to one individual. That individual should monitor new publications, determine which should be obtained, and periodically advise professional personnel of additions to the library.

The foregoing matters were considered in determining our opinion set forth in our report dated August 31, 19XX, and this letter does not change that report.

[Same signature as on the report on the on-site quality review]

Appendix F

.80

Illustration of Response by a Reviewed Firm to a Letter of Comments on an On-Site Quality Review

The purpose of a letter of response is to describe the remedial, corrective actions that the firm has taken or will take to prevent a recurrence of each matter discussed in the letter of comments. If the reviewed firm disagrees with one or more of the findings or recommendations in the letter of comments, its response should describe the reasons for such disagreement. The letter of response should be carefully prepared because of the important bearing it may have on the decisions reached in connection with acceptance of the report on the review (see the section of these Standards on "Acceptance of Reviews" [paragraphs .68 through .73]).

* * * *

September 15, 19XX

[Addressed to the Entity Administering the Review, which may be the AICPA Quality Review Division or a participating State Society of CPAs]

Ladies and Gentlemen:

This letter represents our response to the letter of comments issued in connection with our firm's on-site quality review for the year ended June 30, 19XX. The matters discussed herein were brought to the attention of all professional personnel at a training session held on September 10, 19XX.

Matters That Resulted in a Modified Report

Partner Involvement in Audit Planning—The firm modified its quality control policies and procedures to require partner involvement in the planning stage of all audit engagements. In addition, we identified review engagements that are sufficiently large or complex to warrant partner involvement in the planning stage. The revised policies and procedures require the engagement partner to document his or her timely involvement in the planning process in the planning section of the written work program. The importance of proper planning, including timely partner involvement, to quality work was emphasized in the training session referred to above.

Matters That Did Not Result in a Modified Report

Financial Reporting and Disclosure Checklists—All professional personnel were reminded of the importance of complying with the firm's policy requiring completion of its financial reporting and disclosure checklist at the training session held on September 10, 19XX. In addition, the firm's engagement review questionnaire is being revised to require the engagement partner to document his or her review of the completed checklist. (The engagement review questionnaire is a brief form completed by the engagement partner and manager at the conclusion of an audit to document their completion of their assigned responsibilities.)

Responsibility for Reference Library—The responsibility for keeping the firm's reference library comprehensive and up to date and for advising professional personnel of additions to the library has been assigned to an experienced audit manager. Current editions of industry audit and accounting guides have been ordered.

17,436

Quality Review

* * * *

We believe these actions are responsive to the findings of the review.
Sincerely,

[Name of Firm]

Appendix G

.81

Considerations Governing the Type of Report Issued on an Off-Site Quality Review**Significant Departures Requiring Disclosure in the Report**

1. The objective of an off-site quality review is to provide the reviewer with a reasonable basis for expressing limited assurance that the financial statements and related accountant's report on review and compilation engagements submitted for review do not depart in a material respect from the requirements of professional standards. Accordingly, when the review discloses significant departures from professional standards in the engagements reviewed, those departures should be clearly described in the review report as exceptions to the limited assurance expressed in the report. In this context, a significant departure from professional standards involves—

- a. A departure from the measurement or disclosure requirements of generally accepted accounting principles or, where applicable, an other comprehensive basis of accounting, that can have a significant effect on the user's understanding of the financial information presented and that is not described in the accountant's report. Examples might include a failure to provide an allowance for doubtful accounts when it is probable that a material amount of accounts receivable is uncollectible; the use of an inappropriate method of revenue recognition; a failure to capitalize financing leases or to make important disclosures about significant leases; a failure to disclose significant related party transactions; or a failure to disclose key assumptions in a financial forecast.
- b. The issuance of a review or compilation report that is misleading in the circumstances. Examples might include a review report on financial statements that omit substantially all of the disclosures required by generally accepted accounting principles; a compilation report that does not refer to such omission; or a review report that refers to conformity with generally accepted accounting principles when the financial statements have been prepared on an other comprehensive basis of accounting.

Circumstances Calling for an Adverse Report

2. As indicated in these Standards, an off-site quality review does not provide the reviewer with a basis for expressing any form of assurance on the reviewed firm's quality control policies and procedures, but it may provide the reviewer with a basis for expressing a conclusion that the firm did not have reasonable assurance of conforming with professional standards in the conduct of its accounting practice during the year under review. Deciding whether the findings of an off-site quality review support the expression of such an opinion requires the careful exercise of professional judgment. In reaching a decision, the reviewer would ordinarily consider—

- a. The pattern and pervasiveness of significant departures from professional standards, as described above, that were disclosed by the review. For example, an adverse opinion might not be appropriate if the departures were isolated to the work of one partner or to

engagements in one industry or related to the same accounting or reporting issue.

- b. The response of the reviewed firm to the departures noted.

Other Departures That May Require Disclosure

3. The reviewer may note other departures from professional standards that are not deemed to be significant departures but that should be considered by the reviewed firm in evaluating the quality control policies and procedures over its accounting practice. The reviewer should describe these findings in the review report.

Appendix H

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Standard Form for an Unmodified Report on an Off-Site Quality Review

[AICPA, State Society, or Firm letterhead, as applicable]

August 31, 19XX

To the Partners

Able, Baker & Co.

or

To John B. Able, CPA

We have performed an off-site quality review with respect to the accounting practice of [Name of Firm] for the year ended June 30, 19XX, in accordance with standards established by the American Institute of Certified Public Accountants. [Name of Firm] has represented to us that it performed no audits of historical or prospective financial statements during the year ended June 30, 19XX.

An off-site quality review consists only of reading selected financial statements and the accountant's compilation or review report thereon, together with certain information and representations provided by the firm, for the purpose of considering whether the financial statements appear to be in conformity with generally accepted accounting principles or, if applicable, with an other comprehensive basis of accounting, and whether the accountant's report appears to conform with the requirements of professional standards. An off-site quality review does not provide the reviewer with a basis for expressing any assurance as to the firm's quality control policies and procedures for its accounting practice, and we express no opinion or any form of assurance on them.

In connection with our off-site quality review, nothing came to our attention that caused us to believe that the compilation and review reports submitted for review by [Name of Firm] and issued in the conduct of its accounting practice during the year ended June 30, 19XX, did not conform with the requirements of professional standards in all material respects.

John Brown, Reviewer*

[or Name of Reviewing Firm]

*The description *Reviewer*, not *Team Captain*, should be used in reports on off-site quality reviews.

Appendix I

.83

Illustrations of Modified Reports on an Off-Site Quality Review**Disclosure of Significant Departures in the Report***[Modified concluding paragraphs after the first two standard paragraphs]*

In connection with our off-site quality review, with the exception of the matters described in the following paragraph, nothing came to our attention that caused us to believe that the compilation and review reports submitted for review by *[Name of Firm]* and issued in the conduct of its accounting practice during the year ended June 30, 19XX, did not conform with the requirements of professional standards in all material respects.

The firm's review report on the financial statements of one of the engagements submitted for review did not disclose the failure to capitalize a financing lease, as required by generally accepted accounting principles. Also, financial statement disclosure deficiencies related to the components of income tax expense and related party transactions were noted in several of the engagements reviewed.

Adverse Report on an Off-Site Quality Review*[Separate paragraph after the first two standard paragraphs]*

Our review disclosed several failures to adhere to professional standards in reporting on material departures from generally accepted accounting principles and in complying with standards for accounting and review services. Specifically, the firm did not disclose in certain compilation and review reports failures to comply with generally accepted accounting principles in accounting for leases, in accounting for revenues from construction contracts, and in disclosures made in the financial statements or the notes thereto concerning various matters important to an understanding of those statements.

[Modified concluding paragraph]

Because of the significance of the matters described in the preceding paragraph, in our opinion, *[Name of Firm]* did not have reasonable assurance of conforming with professional standards in the conduct of its accounting practice during the year ended June 30, 19XX.

Disclosure of Other Departures in the Report*[Separate paragraph after the first two standard paragraphs]*

Our review identified disclosure deficiencies in the financial statements on several of the engagements submitted for review. Also, on one engagement, the firm's review report did not indicate the degree of responsibility being taken for supplementary information accompanying the basic financial statements, as required by professional standards. However, none of these matters were considered to be significant departures from professional standards.

[Standard concluding paragraph]

In connection with our off-site quality review, nothing came to our attention that caused us to believe that the compilation and review reports submitted for review by *[Name of Firm]* and issued in the conduct of its accounting practice during the year ended June 30, 19XX, did not conform with the requirements of professional standards in all material respects.

Appendix J

.84

Illustration of Response by a Reviewed Firm to a Modified Report on an Off-Site Quality Review

The purpose of a letter of response to a modified report on an off-site quality review is to describe the remedial, corrective actions that the firm has taken or will take to prevent a recurrence of each matter discussed in the report. If the reviewed firm disagrees with one or more of the findings in the report, its response should describe the reasons for such disagreement. The letter of response should be carefully prepared because of the important bearing it may have on the decisions reached in connection with acceptance of the report on the review (see the section of these Standards on "Acceptance of Reviews" [paragraphs .68 through .73]).

* * * *

September 15, 19XX

[Addressed to the Entity Administering the Review, which may be the AICPA Quality Review Division or a participating State Society of CPAs]

Ladies and Gentlemen:

This letter represents (our) (my) response to the report on the off-site quality review of (our firm's) (my) accounting practice for the year ended June 30, 19XX. That report commented on the failure to capitalize a financing lease in financial statements (we) (I) had reviewed and noted that there were financial statement disclosure deficiencies in several of the engagements reviewed.

(The firm has) (I have) recalled all copies of the review report on the financial statements that did not reflect the capitalization of a financing lease in accordance with generally accepted accounting principles, and corrected financial statements are being prepared.

To prevent the recurrence of this situation, as well as to prevent the other disclosure deficiencies referred to in the report on the off-site quality review, (we) (I) have obtained copies of the AICPA's reporting and disclosure checklists. These checklists will be completed on all review engagements and on selected compilation engagements.

In addition, (our) (my) staff have been advised of the importance of consultation within the firm when they encounter unfamiliar situations and have been encouraged to use the AICPA Technical Information Hotline in those circumstances.

(We) (I) believe these actions are responsive to the findings of the review.

Sincerely,

[Name of Firm]

Quality Review Executive Committee (1988-1989)MICHAEL A. WALKER, *Chairman*

GERALD H. BANWART

BRUCE S. BOTWIN

PAUL R. BROWNER

BERNARD W. GRATZER*

BRUCE N. HUFF

WILLIAM G. KOCH

DUANE W. KUEHL

ZENO H. MONTGOMERY

SCOTT R. NELSON

SABINO OLIVAS III

MICHAEL J. SCHWARZ

JOSEPH SPERSTAD*

C. DAVID STAUFFER

THOMAS P. KELLEY,*Group Vice President,**Professional*

DALE E. RAFAL,

Director, Quality Review

*Consultant

[The next page is 17,601.]

QR Section 9000

INTERPRETATIONS OF STANDARDS FOR PERFORMING AND REPORTING ON QUALITY REVIEWS

Interpretations of the Standards for Performing and Reporting on Quality Reviews are developed in open meetings by the Quality Review Executive Committee for reviews conducted under the quality review program. Interpretations of standards need not be exposed for comment and are not the subject of public hearings. These interpretations are applicable to firms enrolled in the quality review program, to individuals and firms who perform and report on such reviews, to state CPA societies that participate in the administration of the program, to associations of CPA firms that assist their members in arranging and carrying out quality reviews, and to the AICPA Quality Review Division itself.

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QR Section 9100

Standards for Performing and Reporting on Quality Reviews: Quality Review Interpretations of QR Section 100

1. Reviews of Sole Practitioners Who Audit Historical or Prospective Financial Statements

.01 *Standards for Performing and Reporting on Quality Reviews* requires firms that perform audits of historical or prospective financial statements to have on-site quality reviews (section 100.04). The review should provide the reviewer with a reasonable basis for expressing an opinion on whether during the year under review the reviewed firm's system of quality control for its accounting and auditing practice met the objectives of quality control standards established by the AICPA and was being complied with in order to provide the reviewed firm with reasonable assurance of conforming with professional standards.

.02 To achieve those objectives, the reviewer is required to test administrative and personnel files; review selected engagements, including the relevant working paper files and reports; interview firm personnel; access other evidential matter, as appropriate; and communicate his or her conclusions to senior members of the reviewed firm at an exit conference. It was contemplated that these procedures would be performed in the most practicable, cost-effective manner during a visit to the reviewed firm and, thus, the term "on-site quality reviews" was used in the *Standards*. However, many sole practitioners believe that their reviews could be carried out at less cost if they were permitted to send the required files, reports, and other evidential matter to the reviewer.

.03 A review conducted at the reviewer's office or another agreed-upon location can achieve the objectives of an on-site quality review and can be described as such in the reviewer's report provided that (1) the reviewed firm is a sole practitioner with four or fewer professional staff; (2) the sole practitioner holds one or more meetings, by telephone or in person, with the reviewer to discuss the firm's responses to the quality control policies and procedures questionnaire, engagement findings, and the reviewer's conclusions on the review; and (3) in addition to materials outlined in the "Instructions to Firms Having an On-Site Quality Review" (see QRP section 4100.07), the sole practitioner sends the following materials to the reviewer prior to the review:

- a. All documentation related to the resolution of independence questions (a) identified during the year under review with respect to any audit or accounting client or (b) related to any of the audit or accounting clients selected for review, no matter when the question was identified if the matter still exists during the review period.
- b. The most recent independence confirmations received from other firms of CPAs engaged to perform segments of engagements on which the sole practitioner acted as principal auditor or accountant.
- c. The most recent representations received from all professional staff concerning their compliance with applicable independence requirements.

- d. Documentation, if any, of consultations with outside parties during the year under review in connection with audit or accounting services provided to any client.
- e. A list of relevant technical publications used as research materials, as referred to in question B.4 of the Questionnaire (see QRP sections 4200.02.B.4 and 4300.02.C.4).
- f. A list of audit and accounting materials, if any, identified in response to the questions in the "Supervision" section of the Questionnaire (see QRP section 4200.02.C).
- g. CPE records sufficient to demonstrate compliance by the CPAs in the firm with state and AICPA continuing professional education requirements.
- h. The relevant working paper files and reports on the engagements selected for review.
- i. Any other evidential matter requested by the reviewer.

.04 In the event that deficiencies are noted during the review of selected engagements, the scope of the review may have to be expanded before the review can be completed.

.05 A sole practitioner and the reviewer should mutually agree on the appropriateness and efficiency of this approach to the quality review.

[Issue Date: May, 1990; Amended: July, 1992]

2. Selection in On-Site Quality Reviews of Audits Conducted Pursuant to the Employee Retirement Income Security Act of 1974

.06 *Question*—During 1990, regulators and legislators focused attention on the quality of audits conducted pursuant to the Employee Retirement Income Security Act of 1974. If a firm performs such audits, should one of those engagements be selected for review in an on-site quality review?

.07 *Answer*—*Standards for Performing and Reporting on Quality Reviews* requires that the engagements selected for review in an on-site quality review provide a reasonable cross-section of the reviewed firm's accounting and auditing practice and that greater weight be given to audit engagements that meet the following criteria:

- a. Engagements in which there is a significant public interest, such as publicly held clients, financial and lending institutions, and brokers and dealers in securities.
- b. Engagements in other specialized industries.
- c. Engagements that are large, complex or high risk or that are the reviewed firm's initial audits of clients.

In addition, the *Standards* requires that the sample of engagements include at least one audit conducted pursuant to *Government Auditing Standards* issued by the U.S. General Accounting Office (QRP section 3000.41—.42).

.08 In selecting engagements for review, the reviewer should consider whether "high risk" engagements and engagements with a "significant public interest" have been identified by the firm as a result of the application of its quality control policies and procedures on, for example, acceptance and continuance of clients, supervision, or consultation. The reviewer should also consider whether certain industries represented in the reviewed firm's accounting and auditing practice should be given greater weight in the engagement selection process because engagements in those industries pose a higher risk

because of economic or business conditions or because there is a significant public interest in those engagements as evidenced by, for example, regulatory or legislative requirements or developments. The reviewer should also consider requirements that may have been published by regulatory agencies with respect to the peer or quality review process.

.09 Regulatory and legislative developments during 1990 have made it clear that there is a significant public interest in audits conducted pursuant to the Employee Retirement Income Security Act of 1974. Accordingly, greater weight should be given in the engagement selection process on on-site reviews to those audits if the firm performs such engagements.

[Issue Date: March, 1991.]

3. Team Captain Qualifications: Association With a Firm That Had an Unqualified Review Within the Previous Three Years

.10 *Question*—If a reviewer's firm has not had a review within the previous three years because the firm's review was postponed by the administering entity, is the reviewer permitted to serve as a team captain on a quality review?

.11 *Answer*—The *Standards for Performing and Reporting on Quality Reviews* (section 100.18) requires that a team captain be associated with a firm that has received an unqualified report on its system of quality control within the previous three years. The Standards also state that the requirement becomes effective on January 1, 1992. However, if the firm has had a review prior to that date, the report on the review must be unqualified.

.12 In rare circumstances, reviews may be postponed as the result of a request by the AICPA or another administering entity to balance its administrative workload. In such circumstances, the requirement that a team captain's firm must have a review within the previous three years may be waived for a period of time equal to the length of the postponement provided that (1) all of the other requirements for service as a team captain are met and (2) the firm's most recent review resulted in an unqualified report.

[Issue Date: August, 1991.]

4. Requirements for Off-Site Reviews Conducted by Members of Associations of CPA Firms

.13 *Question*—May a member of an association of CPA firms perform an off-site review of a firm that is a member of the same association?

.14 *Answer*—The *Standards for Performing and Reporting on Quality Reviews* [section 100.15 and .50] permit associations of CPA firms to assist its members by organizing review teams to carry out on-site reviews for its members but prohibit associations from arranging or carrying out off-site quality reviews.

.15 Reviewers associated with firms that are members of an association of CPA firms may perform off-site reviews for other members of the association provided that the association is *not* involved in arranging or carrying out these reviews and provided the firms are independent of each other.

.16 Assisting association members in carrying out or arranging a review includes, but is not limited to, the following activities:

- Verifying the qualifications of off-site reviewers.
- Providing program materials for the performance of off-site reviews.
- Providing consultations on technical accounting, ethics and quality review program matters.

- Resolving disagreements and disputes.
- Monitoring the completion of reviews.
- Receiving review working papers.

[Issue Date: November, 1991.]

5. Off-Site Reviewer Qualifications: Association With a Firm That Has Had a Review

.17 *Question*—Must an off-site reviewer who is in the practice of public accounting be associated with a firm that has had a previous review and must the report on that review be unqualified?

.18 The *Standards for Performing and Reporting on Quality Reviews* (Standards), paragraphs 17 and 25 [section 100.17 and .21] indicate that an off-site reviewer must:

- Be a member of the AICPA licensed to practice as a certified public accountant.
- Possess current knowledge of applicable professional standards.
- Have at least five years' experience in the accounting or auditing function of an enrolled firm within the last 10 years, culminating in a position as either a proprietor, partner, shareholder, or manager or person with equivalent supervisory responsibilities.

.19 The *Standards* [section 100.18] also state that an on-site quality review team captain must be associated with a firm that has received an unqualified report on its system of quality control within the previous three years. This provision becomes effective January 1, 1992, except if the team captain's firm has had a review before that date, the report on the review must also be unqualified. However, the *Standards* are silent regarding the application of this requirement to firms or reviewers in the practice of public accounting who perform off-site quality reviews.

.20 *Answer*—Although the *Standards* are silent regarding the application of the requirement for an unqualified report to an off-site review, there is no logical basis for concluding that the requirement should not be equally applicable to off-site reviews. (Moreover, the Quality Review Executive Committee is authorized to establish procedures for the administration of the program, and this is more a matter of appropriate administrative policy than the strict interpretation of the *Standards*.) Accordingly, effective January 1, 1992, an off-site reviewer who is in the practice of public accounting must be associated with a firm that has had a review. If the firm has an on-site review, the report must be unqualified. If the firm has an off-site review, the report must not be adverse or modified for significant departures from professional standards. (See Appendixes H and I of the *Standards* [section 100.82 and .83] for the types of reports.) If the firm has a review before January 1, 1992, the report on that review must meet the same requirements.

.21 If a reviewer is associated with more than one firm, then all of the firms subject to a peer or quality review must not have received an adverse report or a report modified for significant departures from professional standards. Also, if any of the firms with which the reviewer is associated have had an on-site peer or quality review, those firms must have received an unqualified report.

[Issue Date: December, 1991.]

6. Off-Site Reviewer Qualifications: Performance of Firm-on-Firm Off-Site Reviews

.22 Question—Can firms not enrolled in a practice-monitoring program perform firm-on-firm off-site reviews?

.23 Answer—No. In order to perform firm-on-firm off-site reviews, an individual must be associated with a firm enrolled in an approved practice-monitoring program.

[Issue Date: December, 1991.]

7. Selection of SEC Engagements in On-Site Quality Reviews

.24 Question—Firms that audit one or more SEC clients as defined by Council in an implementing resolution under bylaw section 2.3.5 [BL section 230.01] may enroll in the quality review program only when they have resigned, declined to stand for re-election, or been dismissed as auditor of all such clients. In that event, should one or more of such engagements be selected for review in the firm's on-site quality review?

.25 Answer—The *Standards for Performing and Reporting on Quality Reviews* [section 100] states that "greater weight should be given to audit engagements . . . in which there is a significant public interest, such as publicly held clients, financial and lending institutions, and brokers and dealers in securities." This guidance applies to all SEC audit engagements carried out during the year under review, whether or not the entities involved remain clients of the firms.

.26 In addition, the reviewer should satisfy himself or herself that the SEC has been notified by appropriate filings of Form 8-Ks that the firm has resigned, declined to stand for re-election, or been dismissed as auditor of the SEC clients that were clients at any time since the date of the firm's last peer review or quality review or during the year under review if the reviewed firm has not previously had a review.

[Issue Date: July, 1992.]
