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AICPA Professional Standards: Peer review as of June 1, 1997

American Institute of Certified Public Accountants. Peer Review Board

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AICPA

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

AICPA Professional Standards

Volume 2

Accounting & Review Services

Code of Professional Conduct

Bylaws

International Accounting

International Auditing

Consulting Services

Quality Control

Peer Review

Tax Practice

Personal Financial Planning

Continuing Professional Education

As of June 1, 1997

PR Section
PEER REVIEW

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PR Section 100

Standards for Performing and Reporting on Peer Reviews (Effective for Peer Review Years Beginning on or After January 1, 1997)

NOTICE TO READERS

Members of the American Institute of Certified Public Accountants (AICPA) who are engaged in the practice of public accounting in the United States or its territories are required to be practicing as owners or employees of firms enrolled in an approved practice-monitoring program in order to retain their membership in the AICPA.

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

These Standards are effective for peer review years beginning on or after January 1, 1997, for firms enrolled in the AICPA peer review program and firms that are members of the Private Companies Practice Section. They are applicable to firms enrolled in these programs and to individuals and firms who perform and report on such reviews, to state CPA societies administering the reviews, and to associations of CPA firms assisting their members in arranging and carrying out peer reviews. Individuals using these Standards should be knowledgeable about interpretations issued by the AICPA Peer Review Board that might impact the application of these Standards.

Reviews of firms that are members of the SEC Practice Section of the AICPA Division for CPA Firms are carried out under the Standards issued by the SEC Practice Section's Peer Review Committee that address, among other things, the various membership requirements of the section applicable to audits of SEC clients.

Introduction

.01 Quality in the performance of accounting and auditing engagements by AICPA members is the goal of the AICPA peer 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 Firms in the AICPA peer review program need to—

- a. Establish and maintain appropriate quality control policies and procedures and comply with them to ensure the quality of their practices.
- b. Have independent peer reviews of their accounting and auditing practices at least once every three years.
- c. Take remedial, corrective actions as needed.

.03 Statement on Quality Control Standards (SQCS) No. 2, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice* [QC section 20], requires every CPA firm, regardless of its size, to have a system of quality control for its accounting and auditing practice. It identifies five elements of quality control and states that the nature, extent, and formality of a firm's quality control policies and procedures should be appropriately comprehensive and suitably designed in relation to the firm's size, the number of its offices, the degree of operating autonomy allowed its personnel and its offices, the knowledge and experience of its personnel, the nature and complexity of the firm's practice, and appropriate cost-benefit considerations.

.04 An accounting and auditing practice for the purposes of the AICPA's *Standards for Performing and Reporting on Peer Reviews* is defined as all engagements covered by Statements on Auditing Standards (SAS); Statements on Standards for Accounting and Review Services (SSARS);¹ the Statement on Standards for Attestation Engagements (SSAE), *Financial Forecasts and Projections* [AT section 200]; attest services on financial information when the firm audits, reviews, or compiles the historical financial statements of the client; and standards for financial and compliance audits contained in *Government Auditing Standards* (the Yellow Book), issued by the U.S. General Accounting Office (GAO).

.05 The objectives of the AICPA peer review program are achieved through the performance of peer reviews involving procedures tailored to the size of the firm and the nature of its practice. Firms that perform audits of historical financial statements, agreed-upon procedures under SAS No. 75, *Engagements to Apply Agreed-Upon Procedures to Specified Elements, Accounts, or Items of a Financial Statement* [AU section 622], or examinations of prospective financial statements have on-site peer reviews. Firms that perform services listed in paragraph .04 that are not required to have on-site peer reviews have off-site peer reviews. Firms that do not provide any of the services listed in paragraph .04 are not reviewed.

.06 Upon completing a peer review, the review team prepares a written report and, when applicable, a letter of 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 letter of comments (findings and recommendations) to the state CPA society administering its review. These documents are not public documents, unless the firm is a member of the Private Companies Practice Section of the AICPA Division for CPA Firms. However, the reviewed firm may make the documents available to the public if it so chooses after they have been formally accepted by the state CPA society administering the review.

.07 The program is based on the principle that a systematic monitoring and educational process is the most effective way to attain high-quality per-

¹ Statements on Standards for Accounting and Review Services (SSARS) that provide an exemption from those standards in certain situations are likewise excluded from this definition of an accounting and auditing practice for peer review purposes.

formance throughout the profession. Thus, it depends on mutual trust and cooperation. The reviewed firm is expected to take appropriate actions in response to deficiencies in its system of quality control, its compliance with that system, or both. These actions will be positive and remedial. Disciplinary actions (including actions that can result in the termination of a firm's enrollment in the peer review program or membership in the Private Companies Practice Section (PCPS) of the AICPA Division for CPA Firms, and the subsequent loss of membership in the AICPA and some state CPA societies by its owners and 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

.08 The ownership of firms enrolled or seeking enrollment in the AICPA peer review program should comply with Council resolutions [ET appendix B]. In addition, at least one of the firm's owners has to be a member of the AICPA.²

Confidentiality

.09 A peer review should be conducted in compliance with the confidentiality requirements set forth by the AICPA in the section of the Code of Professional Conduct titled *Confidential Client Information* [ET section 301]. 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.

.10 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 peer reviews are undertaken. The reviewed firm may advise its clients that it will have a peer review and that accounting or auditing work for that client may be subject to review.

Independence, Integrity, and Objectivity

.11 Independence (in fact and in appearance) should 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. In addition, the review team should perform all peer review responsibilities with integrity and maintain objectivity in discharging those responsibilities.

.12 *Independence* encompasses an impartiality that recognizes an obligation for fairness not only to the reviewed firm but also to those who may use

² The exhibit in paragraph .94 includes summarized information from the AICPA's PCPS publication *What You Need to Know About Membership in the Private Companies Practice Section (PCPS): Advocacy, Action, Answers* concerning the Private Companies Practice Section membership requirements and additional peer review requirements.

the review team's peer review report on the reviewed firm. The reviewing firm, the review team, and any other individuals who participate on the peer review should be free from any obligation to or interest in the reviewed firm or its personnel. The concepts in the AICPA Code of Professional Conduct's Article III, *Integrity*, and Article IV, *Objectivity and Independence* [ET sections 54 and 55], should be considered in making independence judgments. In that connection, the specific requirements set forth in appendix A [paragraph .95] apply. *Integrity* requires the review team to be honest and candid within the constraints of the reviewed firm's confidentiality. Service and the public trust should not be subordinated to personal gain and advantage. *Objectivity* is a state of mind and a quality that lends value to a review team's services. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest.

Competence

.13 A review team conducting a peer review should have current knowledge of the professional standards applicable to the type of practice to be reviewed. Individuals reviewing engagements should have recent experience in the industries of the engagements selected for review. See paragraph .18 for a description of the qualifications an individual should possess to serve on a review team.

Due Professional Care

.14 Due professional care as addressed by the AICPA Code of Professional Conduct in Article V, *Due Care* [ET section 56], should 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.

Administration of Reviews

.15 Reviews intended to meet the requirements of the AICPA peer review program should be carried out in conformity with these Standards under the supervision of a state CPA society authorized by the AICPA Peer Review Board to administer peer reviews. This imposes an obligation on reviewed firms to arrange and schedule their reviews in compliance with the procedures established by the state CPA society administering its review, and to cooperate with the society and with the AICPA Peer Review Board in all matters related to the review.

Organization of the Review Team

.16 A review team may be formed by a firm engaged by the firm under review (a firm-on-firm review), a state CPA society participating in the program (a committee-appointed review team, also known as a CART review), or an association of CPA firms authorized by the AICPA Peer Review Board to assist its members by organizing review teams to carry out on-site and off-site peer reviews (an association review).

.17 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 supervising

and conducting the review, communicating the review team's findings to the reviewed firm and to the state CPA society administering the review,³ and preparing the report and, if applicable, the letter of comments on the review. The team captain should supervise and review the work performed by other reviewers on the review team to the extent deemed necessary in the circumstances.

Qualifications for Service as a Reviewer

General

.18 Performing and reporting on a peer review requires the exercise of professional judgment by peers. (See paragraphs .85 through .91 for a discussion of a reviewer's responsibilities when performing a peer review.) Accordingly, an individual serving as a reviewer (whether for an on-site or off-site peer review)⁴ should—

- a. Be a member of the AICPA licensed to practice as a certified public accountant with an enrolled firm that, if reviewed, has received an unqualified report on its system of quality control or its off-site peer review.
- b. Possess current knowledge of applicable professional standards. This includes knowledge about current rules and regulations applicable to the industries for which engagements are reviewed. Such knowledge may be obtained from on-the-job training, training courses, or a combination of both.
- c. Have at least five years of recent experience⁵ in the practice of public accounting in the accounting or auditing function.
- d. Be currently active in public practice at a supervisory level in the accounting or auditing function⁶ of a firm enrolled in an approved practice-monitoring program (that is, a firm enrolled in the AICPA peer review program or a firm that is a member of the AICPA Division for CPA Firms) as an owner of the firm or as a manager or person with equivalent supervisory responsibilities. To be considered

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

⁴ See the exhibit in paragraph .94 for additional qualifications needed by individuals performing reviews of firms in the Private Companies Practice Section.

⁵ For this purpose, *recent* means having experience in the industries for which engagements are reviewed within the last five years. However, a reviewer should be cautious of those high-risk industries or industries where new standards have been implemented. For example, in those cases where new industry standards or practices have occurred in the most recent year, it may be necessary to have *current* practice experience in that industry in order to have *recent* experience.

⁶ The AICPA Peer Review Board 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 of 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 peer review with professional expertise. For instance, a reviewer of auditing engagements should ordinarily be currently reviewing or performing auditing engagements.

currently active in the accounting or auditing function, a reviewer should be currently involved in the accounting or auditing practice of a firm supervising one or more of the firm's accounting or auditing engagements or carrying out a quality control function on the firm's accounting or auditing engagements.

.19 A reviewer of an engagement in a high-risk industry should possess not only current knowledge of professional standards but also current knowledge of the accounting practices specific to that industry. In addition, the reviewer of an engagement in a high-risk industry should have current practice experience in that industry. If a reviewer does not have such experience, the reviewer may be called upon to justify why he or she should be permitted to review engagements in that industry. The state CPA society administering the review has the authority to decide whether a reviewer's experience is sufficient to perform a particular review.

.20 An individual may not serve as an on-site or off-site reviewer if his or her ability to practice accounting or auditing has been limited or restricted in any way by a regulatory, monitoring, or enforcement body until the limitation or restriction has been removed. If the limitation or restriction has been placed on the firm, or one or more of its offices, then none of the individuals associated with the firm, or the portion thereof, may serve as reviewers.

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

.22 An individual who starts or becomes associated with a newly formed firm (which has not had a peer review) may serve as an on-site team captain or off-site reviewer during the twelve-month transitional period, beginning with the earlier of the date of disassociation from the previous firm or of starting a new firm. The previous firm, if applicable, should have received an unqualified report on its most recently completed peer review and the individual should have all of the other qualifications for service as an on-site team captain or an off-site reviewer.

On-Site Team Captain

.23 In addition to adhering to the general requirements for a reviewer, an individual serving as a team captain on an on-site peer review should—

- a. Be an owner of an enrolled firm that has received an unqualified report on its system of quality control for its accounting and auditing practice for its most recently completed peer review. If the individual is associated with more than one firm, then each of the firms the individual is associated with should have received an unqualified report on its most recently completed peer review of its accounting and auditing practice.
- b. Have completed a training course or courses that meet requirements established by the AICPA Peer Review Board.

Off-Site Reviewer

.24 In addition to adhering to the general requirements for a reviewer, an individual serving as a reviewer on an off-site peer review (available to firms

that perform no audits of historical financial statements, agreed-upon procedures under SAS No. 75 [AU section 622], or examinations of prospective financial statements) should—

- a. Have completed a training course or courses that meet requirements established by the AICPA Peer Review Board.
- b. Be associated with a firm that has received, on its most recently completed peer review, either an unqualified report on its system of quality control or an unqualified report on its off-site peer review. If the individual is associated with more than one firm, then each of the firms the individual is associated with should have received an unqualified report on its most recently completed peer review of its accounting practice.

Performing On-Site Peer Reviews

Objectives

.25 An on-site peer 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 has been designed in accordance with quality control standards established by the AICPA (see SQCS No. 2 [QC section 20]).
- b. The reviewed firm's quality control policies and procedures were being complied with to provide the firm with reasonable assurance of conforming with professional standards.
- c. If applicable, the reviewed firm was complying with the membership requirements of the Private Companies Practice Section of the AICPA Division for CPA Firms in all material respects. (See the exhibit in paragraph .94 for a description of the membership requirements.)

.26 Firms that perform audits of historical financial statements, agreed-upon procedures under SAS No. 75 [AU section 622], or examinations of prospective financial statements have on-site peer reviews because of the public interest in the quality of such engagements and the importance to the accounting profession of maintaining the quality of those services.

Peer Review Risk

.27 Just as the performance of an audit includes audit risk, the performance of an on-site peer review includes peer review risk. Peer review risk is the risk that the review team—

- a. Fails to identify significant weaknesses in the reviewed firm's system of quality control for its accounting and auditing practice, its compliance with that system, or both.
- b. Issues an inappropriate opinion on the reviewed firm's system of quality control for its accounting and auditing practice, its compliance with that system, or both.
- c. Reaches an inappropriate decision about the findings to be included in or excluded from the letter of comments, or about whether to issue a letter of comments.

.28 Peer review risk consists of the following two parts:

- a. The risk (consisting of inherent risk⁷ and control risk⁸) that an engagement will fail to comply with professional standards, that the reviewed firm's system of quality control will not prevent such failure, or both
- b. The risk (detection risk) that the review team will fail to detect the design or compliance deficiencies in the reviewed firm's system of quality control that either result in the firm having less than reasonable assurance of conforming with professional standards or constitute conditions whereby there is more than a remote possibility that the firm will not conform with professional standards on accounting and auditing engagements

.29 Inherent risk and control risk relate to the reviewed firm's accounting and auditing practice and its system of quality control and should be assessed by the review team in planning the review. Based on that assessment, the review team determines the offices and engagements to be selected for review to reduce peer review risk to an acceptable low level. The lower the inherent and control risk, the higher the detection risk that can be tolerated and vice versa. The assessment of these risks is qualitative and not quantitative.

Basic Requirements

.30 An on-site review should include the following procedures:

- a. Plan the review, as follows:
 1. Obtain a sufficient understanding of the nature and extent of the firm's accounting and auditing practice to plan the review (see paragraph .39).
 2. Obtain a sufficient understanding of the design of the firm's system of quality control, including an understanding of the monitoring procedures performed since the prior review, to plan the review (see paragraph .40).
 3. Assess the peer review risk (see paragraphs .41 and .42).
 4. Use the knowledge obtained from the foregoing to select the offices and the engagements to be reviewed, and to determine the nature and extent of the tests to be applied in the functional areas (see paragraphs .43 through .49).
- b. Perform the review, as follows:
 1. Review compliance by the firm with its system of quality control. The review should cover all organizational or functional levels within the firm.

⁷ Inherent risk is the likelihood that an accounting or auditing engagement will fail to comply with professional standards, assuming the firm does not have a system of quality control.

⁸ Control risk is the risk that a firm's system of quality control will not prevent the performance of an engagement that does not comply with professional standards. It consists of two parts: the firm's control environment and its quality control policies and procedures. The control environment represents the collective effort of various factors on establishing, enhancing, or mitigating the effectiveness of specific quality control policies and procedures. The control environment reflects the overall attitude, awareness, and actions of firm management concerning the importance of quality work and its emphasis in the firm.

2. Review selected engagements, including the relevant working paper files and reports (see paragraphs .50 through .54).
3. If applicable, review compliance with the membership requirements of the Private Companies Practice Section (see the exhibit in paragraph .94).
4. Reassess the adequacy of the scope of the review based on the results obtained to determine if additional procedures are necessary.
5. Have an exit conference with 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 (see paragraph .55).
6. Prepare a written report on the results of the review and, if applicable, a letter of comments (see paragraphs .63 through .68 and .71 through .76).
7. Review and comment to the reviewed firm on the firm's response to the letter of comments, if any (see paragraph .77).

.31 The AICPA Peer Review Board 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 peer review program.

Scope of the Review

.32 The review should cover a firm's accounting and auditing practice as defined in paragraph .04. It 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.

.33 The review should cover a current period of one year to be mutually agreed upon by the reviewed firm and the review team captain. Ordinarily, the review should be conducted within three or four months following the end of the year to be reviewed. Client engagements subject to selection for review ordinarily should be those with periods ending during the year under review. If the current year's engagement is not completed and a comparable engagement within the peer review year is not available, the prior year's engagement should be reviewed. If the subsequent year's engagement has been completed, the review team should consider, based on its assessment of peer review risk, whether the more recently completed engagement should be reviewed instead.

.34 A firm is expected to maintain the same year end on subsequent reviews. However, circumstances may arise that necessitate the firm changing its peer review year end. In such situations, a firm may do so with the prior approval of the state CPA society administering its review.

.35 The team captain should obtain the report on the last review of the firm and, if applicable, the letter of comments and the response thereto, and

the letter accepting those documents. The team captain should consider whether the matters discussed in those documents 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.

.36 A divestiture 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. If the review team is able to review engagements of the divested portion of the reviewed firm's practice, then the review team should review such engagements considered necessary to obtain an appropriate scope for the peer review. In such circumstances, an appropriate scope is one in which the review covers all owners and significant industry areas that existed prior to the divestiture. If the divested portion of the practice is unavailable for review and represents less than ten percent of the reviewed firm's accounting and auditing hours, then the review team does not have to modify the report for a scope limitation. In all other circumstances, the review team should carefully assess the effects the divestiture has on the scope of the peer review. A review team captain who is considering whether a peer review report should be modified for a scope limitation due to a divestiture should consult with the state CPA society administering the review.

.37 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.

.38 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.

Understanding Accounting and Auditing Practice and System of Quality Control

.39 The review team should obtain a sufficient understanding of the nature and extent of the reviewed firm's accounting and auditing practice to plan the review. This understanding should include knowledge about the reviewed firm's organization and philosophy, and the composition of its accounting and auditing practice. This knowledge is ordinarily obtained through such procedures as inquiries of appropriate management personnel and requests of management to provide certain background information, some of which will have been provided to the review team before the review was accepted.

.40 SQCS No. 2 [QC section 20] requires every CPA firm, regardless of its size, to have a system of quality control for its accounting and auditing practice. It states that the quality control policies and procedures applicable to a professional service provided by the firm should encompass the following elements: independence, integrity, and objectivity; personnel management; acceptance and continuance of clients and engagements; engagement performance; and monitoring. The review team should obtain a sufficient understanding of the reviewed firm's system of quality control with respect to each of those five elements to plan the review. The understanding should include knowledge about the design of the reviewed firm's quality control policies and procedures in accordance with quality control standards established by the AICPA. This knowledge is ordinarily obtained through such procedures as inquiries of appropriate management and supervisory personnel, as well as reviewing the firm's responses to a questionnaire developed by the AICPA Peer Review Board.

Assessing Peer Review Risk

.41 In planning the review, the review team should use the understanding it has obtained of the reviewed firm's accounting and auditing practice and its system of quality control to assess the peer review risk associated with those areas. The higher the assessed levels of peer review risk, the greater the number of offices or engagements that need to be reviewed. The assessed level of peer review risk may be affected by circumstances arising within the firm (for example, individual owners have engagements in numerous specialized industries or the firm has a few engagements constituting a significant portion of the firm's accounting and auditing practice) or outside the firm (for example, new professional standards being applied for the first time or adverse economic developments in an industry).

.42 When assessing risk, the review team should evaluate the reviewed firm's quality control policies and procedures over its accounting and auditing practice in relation to the requirements contained in SQCS No. 2 [QC section 20]. This evaluation provides a basis for the review team to determine 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. When making the evaluation, the review team should discuss with the firm how it considered the guidance provided in the AICPA's *Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice*.

Extent of Compliance Tests

.43 Based on its understanding of the reviewed firm's accounting and auditing practice and system of quality control, and its assessment of peer review risk, the review team should consider whether any modifications to the programs and checklists issued by the AICPA Peer Review Board 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 system of quality control was 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. Reviewing 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.
- b. Interviewing firm professional personnel at various levels and, if applicable, other persons responsible for a function or activity, to assess their understanding of and compliance with the firm's quality control policies and procedures.
- c. Reviewing evidential matter to determine that the firm has complied with its policies and procedures for monitoring its system of quality control.
- d. Reviewing other evidential matter as appropriate—for example, selected administrative or personnel files, correspondence files documenting consultations on technical or ethical questions, files evidencing compliance with professional development requirements, and the firm's library.

Selection of Offices

.44 Visits to practice offices should be sufficient to provide the review team with a reasonable basis for its conclusions regarding whether the reviewed firm's quality control policies and procedures are adequately communicated throughout the firm and whether its system of quality control was complied with during the year under review based on a reasonable cross section of the reviewed firm's accounting and auditing practice, with greater emphasis on those offices with higher assessed levels of peer review risk. Examples of the factors to consider when assessing peer review risk at the office level include the following:

- 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 monitoring procedures
- d. Recently merged or recently opened offices
- e. The significance of industry concentrations and of specialty practice areas, such as governmental compliance audits or regulated industries, to the firm and to individual offices

For a multioffice firm, the review should include a visit to the firm's executive office if one is designated as such.

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

Selection of Engagements

.46 When combined with other procedures performed, the number and type of accounting and auditing engagements selected by the review team for review should be sufficient to provide the review team with a reasonable basis

for its conclusions regarding whether the reviewed firm's system of quality control has been designed in accordance with the quality control standards for an accounting and auditing practice established by the AICPA and was being complied with during the year under review.

.47 Engagements selected for review should provide a reasonable cross section of the reviewed firm's accounting and auditing practice, with greater emphasis on those engagements in the practice with higher assessed levels of peer review risk. Examples of the factors to consider when assessing peer review risk at the engagement level include: size, industry area, level of service, personnel (turnover, use of merged-in personnel or personnel not routinely assigned to accounting and auditing engagements), litigation in industry area, and initial engagement.

.48 The AICPA Peer Review Board may from time to time by Interpretations,⁹ require that specific types of engagements be selected for review—for example, engagements required by a regulatory agency to be reviewed or those in particular areas in which public interest exists. Therefore, after selecting the engagements to be reviewed, based on the risk assessment, the team captain should ensure that the scope of the review includes any such required engagements.

.49 The process of engagement selection, like office selection, is not subject to definitive criteria. However, if the team captain finds that meeting all of the criteria discussed above cause the selection of an inappropriate scope of the firm's accounting and auditing practice, the team captain may want to consult with the state CPA society administering the review about the selection of engagements for review. In such circumstances, the team captain 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 peer review 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 based on peer review risk 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, peer review risk should be considered in determining whether more than one of these engagements should be selected for review.

Extent of Engagement Review

.50 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.

.51 For each engagement reviewed, the review team should document whether anything came to its attention that caused it to believe that—

⁹ Reviewers should be alert to Peer Review Standards Interpretations developed by the AICPA Peer Review Board that might affect the engagements selected for review.

- 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.

.52 If the review team answers yes with respect to any of the above items, 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. If the reviewed firm concludes that its report on previously issued financial statements is inappropriate, as addressed in SAS No. 1, section 561 titled *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report* [AU section 561], or the firm's work does not support the report issued, as addressed in SAS No. 46, *Consideration of Omitted Procedures After the Report Date* [AU section 390], the reviewed firm should take timely action, as appropriate, to correct such engagements. 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 (generally on the "Matter for Further Consideration" form prepared by the reviewer).

.53 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 state CPA society 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.

.54 In evaluating the reviewed firm's response, the review team should recognize that it has not audited 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 the state CPA society administering the review may refer unresolved matters to the AICPA Peer Review Board for a final determination.

Exit Conference

.55 Prior to issuing its report and, if applicable, letter of comments, the review team should communicate its conclusions to senior members of the reviewed firm at an exit conference, which may also be attended by representatives of state CPA society administering entities, the AICPA Peer Review Board, or other authorized organizations 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 the findings and recommendations that will be included in the letter of comments. Accordingly, except

in rare circumstances that 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 Peer Reviews

Objectives

.56 The objective of an off-site peer review is to provide the reviewer with a reasonable basis for expressing limited assurance that the financial statements or information and the related accountant's report on the accounting and review engagements and attestation¹⁰ engagements submitted for review, conform in all material respects with the requirements of professional standards. This objective is different from the objectives of an on-site peer review in recognition of the fact that off-site peer reviews are available only to firms that perform no audits of historical financial statements, agreed-upon procedures under SAS No. 75 [AU section 622], or examinations of prospective financial statements. Firms required to have an off-site peer review may elect to have an on-site peer review. Compliance with the positive enforcement program of a state board of accountancy does not constitute compliance with the AICPA practice-monitoring requirement.

Basic Requirements

.57 The criteria for selecting the peer review year end and the period to be covered by an off-site peer review are the same as those for an on-site peer review (see paragraphs .33 and .34). The reviewed firm shall provide summarized information showing the number of its accounting and review engagements and attestation¹¹ engagements, classified into major industry categories. That information should be provided for each owner of the firm who is responsible for the issuance of reports on accounting and review services and attest services. On the basis of that information, the reviewer or the state CPA society administering the review ordinarily should select the types of engagements to be submitted for review, in accordance with the following guidelines.

- a. One engagement should be selected from each area of service performed by the firm:
 1. Review on historical financial statements
 2. Compilation on historical financial statements, with disclosures
 3. Compilation on historical financial statements that omit substantially all of the disclosures required by generally accepted accounting principles or an other comprehensive basis of accounting
 4. Attestation¹¹
- b. One engagement should be selected from each owner of the firm responsible for the issuance of reports listed in *a* above.
- c. Ordinarily, at least two engagements should be selected for review.

¹⁰ See paragraph .04 for a description of the types of attestation engagements included within the definition of an accounting and auditing practice for peer review purposes. The attestation engagement selected for review can be on either prospective financial statements or assertions.

¹¹ See footnote 10.

The above criteria are not mutually exclusive; one of every type of engagement that an owner performs does not have to be reviewed as long as, for the firm taken as a whole, all types of engagements noted in *a* above performed by the firm are covered.

.58 For each engagement selected for review, the reviewed firm shall submit the appropriate financial statements or information and the accountant's report, masking client identity if it desires, along with specified background information and representations about each engagement. If the reviewed firm is a member of the Private Companies Practice Section, the reviewed firm shall also submit information concerning its compliance with the section's membership requirements (see the exhibit in paragraph .94).

.59 An off-site peer review consists only of reading the financial statements or information submitted by the reviewed firm and the accountant's 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 or information and the accountant's report appear to be in conformity with professional standards. An off-site peer 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 peer review.

.60 Accordingly, an off-site peer review does not provide the reviewer with a basis for expressing any form of assurance on the firm's system of quality control 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 reports submitted for review did not conform with the requirements of professional standards.

.61 A firm that has an off-site peer review should 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.

.62 The reviewer performing an off-site peer review should document the work performed using the programs and checklists issued by the AICPA Peer Review Board 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 peer review program.

Reporting on Reviews

General

.63 On an on-site peer review, the team captain (on an off-site peer review, the reviewer) should furnish the reviewed firm with a written report and, where required, a letter of comments within thirty days of the exit conference date or by the firm's peer review due date, whichever is earlier (on an off-site peer review, the earlier of completion date or due date). 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 state CPA society administering the review. The report on an on-site peer review ordinarily should be dated as of the date of the exit conference. The report on an off-site peer review ordinarily should be dated as of the completion of the review procedures.

.64 The team captain or, where provided by its plan of administration, an authorized association of CPA firms should notify the state CPA society administering the review that the review has been completed and should submit to that state CPA society within thirty days of the exit conference date or by the firm's peer review due date, whichever date is earlier, 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 Peer Review Board.

.65 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 state CPA society administering the review within thirty days of the date it received the report and letter of comments or by the firm's peer review due date, whichever date is earlier. Prior to submitting the response to the state CPA society administering the review, the reviewed firm should submit the response to the team captain or, on an off-site review, the reviewer for review and comment.

.66 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 as meeting the requirements of the AICPA peer review program. Neither the state CPA society nor the AICPA shall make the results of the review available to the public,¹² but on request may disclose the following information:

- a. The firm's name and address
- b. The firm's enrollment in the peer 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 Peer Reviews

.67 The written report on an on-site peer review should—

- a. Indicate the scope of the review, including any limitations thereon.
- b. Describe the general characteristics of a system of quality control for an accounting and auditing practice.
- c. Express an opinion on whether the system of quality control for the accounting and auditing practice of the reviewed firm had been designed in accordance with the quality control standards for an accounting and auditing practice established by the AICPA and was being complied with for the year reviewed to provide the firm with reasonable assurance of conforming with professional standards and, if applicable, describe the reason(s) for any qualification of the opinion.

¹² If the firm is a member of the Private Companies Practice Section, the section's membership requirements provide that a copy of the report, letter of comments, if any, and the firm's response thereto be placed in the public files of the AICPA Division for CPA Firms (see the exhibit in paragraph .94).

- d. Express, if the reviewed firm is a member of the Private Companies Practice Section, an opinion on whether the reviewed firm complied with the membership requirements of the section in all material respects and, if applicable, describe the reason(s) for any qualification of the opinion.

.68 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 .96]. The standard form for an unqualified report is illustrated in appendix C [paragraph .97]. Illustrations of qualified and adverse reports are presented in appendix D [paragraph .98].

Reports on Off-Site Peer Reviews

.69 The written report on an off-site peer review should—

- a. Describe the limited scope of the review and disclaim an opinion or any form of assurance about the firm's system of quality control for its accounting practice.
- b. Indicate whether anything came to the reviewer's attention that caused the reviewer to believe that the 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. If adverse, instead of indicating whether anything came to the reviewer's attention, the peer review report should state that the reports submitted for review by the firm did not conform with the requirements of professional standards in all material respects.
- c. Indicate, if the reviewed firm is a member of the Private Companies Practice Section, whether anything came to the reviewer's attention that caused the reviewer to believe that the firm was not complying with the section's membership requirements in all material respects.

.70 In deciding on the type of report to be issued, the reviewer should be guided by the considerations in appendix G [paragraph .101]. The standard form for an unqualified report on an off-site peer review is illustrated in appendix H [paragraph .102]. Illustrations of other types of reports are presented in appendix I [paragraph .103].

Letters of Comments

.71 A letter of comments should be issued in connection with an on-site peer review when there are matters that resulted in qualification(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, or when a Private Companies Practice Section member firm has failed to comply with one or more of the section's membership requirements. The letter should provide reasonably detailed descriptions of the findings and recommendations so that the state CPA society administering the review can evaluate whether the actions taken or planned by the reviewed firm appear appropriate in the circumstances.

.72 If any of the matters included in the letter of comments were included in the letter of comments issued in connection with the firm's prior review, that

fact should be noted in the description of the matter. In such situations, the team captain should evaluate the matter to determine whether the repeat finding is a result of the firm not appropriately implementing the action(s) it stated it would in its prior letter of response or the underlying cause(s) was incorrectly identified and, therefore, the action taken was inappropriate for correcting the matter. In the latter case, the team captain should discuss the matter in detail with the reviewed firm to determine the weakness in the firm's system of quality control that is causing the matter to occur.

.73 The letter of comments on an on-site review should be prepared in accordance with the guidance and illustrations in appendix E [paragraph .99].

.74 A letter of comments should be issued in connection with an off-site peer review when there are matters that resulted in qualification(s) to the standard form of report or when the reviewer notes 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, or when a Private Companies Practice Section member firm has failed to comply with one or more of the section's membership requirements. The letter should provide reasonably detailed descriptions of the findings and recommendations so that the state CPA society administering the review can evaluate whether the actions taken or planned by the reviewed firm appear appropriate in the circumstances.

.75 The letter of comments on an off-site peer review should be prepared in accordance with the guidance and illustrations in appendix J [paragraph .104].

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

Letters of Response

.77 The reviewed firm should respond in writing to the review team's findings and recommendations on matters in the letter of comments. The response should be addressed to the state CPA society administering the review and should describe the actions taken or planned by the reviewed firm with respect to each matter in the letter of comments. If the reviewed firm disagrees with one or more of the comments, its response should describe the reasons for such disagreement. The reviewed firm should submit the response for review and comment to the team captain or, on an off-site review, the reviewer prior to submitting the response to the state CPA society administering the review. An illustration of a response by a reviewed firm for an on-site review is included in appendix F [paragraph .100] and for an off-site review in appendix K [paragraph .105].

Acceptance of Reviews

.78 A committee or report acceptance body (hereafter, the committee) should be appointed by each participating state CPA society for the purpose of considering the results of reviews it administers that are undertaken to meet the requirements of the peer review program. The activities of the committee

should be carried out in accordance with administrative procedures issued by the AICPA Peer Review Board. Committee members may not participate in any discussion or have any vote with respect to a reviewed firm when the member lacks independence or has a conflict of interest with the reviewing firm, the reviewer, or the reviewed firm.

.79 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, including an evaluation of the adequacy of the corrective actions the reviewed firm has represented that it will take in its letter of response.
- 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 individuals to obtain specified types and amounts of continuing professional education, requiring the firm to carry out more comprehensive monitoring procedures, 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, reports on the reviewed firm's monitoring of its practice, or reports by another CPA engaged to perform preissuance reviews of financial statements and reports. Revisits by team captains and accelerated peer reviews are other examples of monitoring procedures.

.80 In reaching its conclusions on the above items, 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. Such inquiries or actions by the committee should be made with the understanding that the peer 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.

.81 If, after consideration of items *.79a* through *.79d* above, the committee concludes that 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.

.82 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 Peer Review Board for final resolution. In these circumstances, the AICPA Peer Review Board may consult with representatives of other AICPA committees or with appropriate AICPA staff.

.83 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 Peer Review Board may decide, pursuant to due process procedures that it has established, to appoint a hearing panel to consider whether the firm's enrollment in the AICPA peer review program should be terminated or whether some other action should be taken.

.84 If a decision is made by the hearing panel to terminate a firm's enrollment in the AICPA peer review program, 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 AICPA peer review program has been terminated shall be reported in an AICPA membership periodical.

Evaluation of Reviewers

.85 A team captain or reviewer (hereafter, reviewer) has a responsibility to perform a review in a timely, professional manner. This relates not only to the initial submission of the report, letter of comments, if any, and working papers on the review, but also to the timely completion of any additional actions necessary to complete the review, such as completing omitted documentation of the work performed on the review or resolving questions raised by the committee accepting the review.

.86 When considering peer review documents for acceptance, the committee evaluates the reviewer's performance on the peer review. If serious deficiencies in the reviewer's performance are noted on a particular review, or if a pattern of deficiencies by a particular reviewer is noted, then the committee, depending on the particular circumstances, will consider the need to impose corrective or monitoring actions on the service of the reviewer. The committee may require the reviewer to comply with certain actions, such as (but not limited to) the following, in order to continue performing reviews:

- a. Attendance at a reviewer's training course and receipt of a satisfactory evaluation from the instructor of the course
- b. Committee oversight on the next review performed by the reviewer at the expense of the reviewer's firm (including out-of-pocket expenses, such as travel cost and per diem charges at the team captain rate established by the state CPA society for the review teams it forms)
- c. Completion of all outstanding peer reviews before performing another review
- d. Preissuance review of the report, letter of comments, and working papers on future reviews by an individual acceptable to the committee chair or designee who has experience in performing peer reviews

.87 In such situations where one or more of such actions is imposed, the state CPA society will inform the AICPA Peer Review Board, which may ratify the action(s) to be recognized by other administering entities and in the SEC Practice Section (SECPS) peer review program.

.88 If corrective or monitoring actions are imposed by the SECPS Peer Review Committee, those actions will also apply to peer reviews performed by the reviewer, unless the actions are specific to the SECPS peer review program, and need not be ratified by the AICPA Peer Review Board. In addition, any condition imposed on a reviewer will generally apply to the individual's service as a team captain or a team member unless the condition is specific to the individual's service as only a team captain or only a team member.

.89 If a reviewer refuses to cooperate with the committee, fails to correct material performance deficiencies, or is found to be seriously deficient in his or her performance, and education or other corrective or monitoring actions are not considered adequate to correct the deficiencies, the committee may recommend to the AICPA Peer Review Board that the reviewer be prohibited from performing peer reviews in the future. In such situations imposed by a committee, the AICPA Peer Review Board should ratify the action(s) taken by the committee for the reviewer's name to be removed from the list of qualified reviewers.

.90 Corrective or monitoring actions can be appealed only to the committee that imposed the actions. For actions imposed or ratified by the AICPA Peer Review Board, if the reviewer disagrees with the corrective or monitoring action, he or she may appeal the decision by writing the AICPA Peer Review Board, and explaining why he or she believes that the actions are unwarranted. Upon receipt of the request, the AICPA Peer Review Board will review the request at its next meeting and take the actions it believes appropriate in the circumstances.

.91 If a reviewer is scheduled to perform a review after he or she has filed an appeal, but before the AICPA Peer Review Board has considered the appeal, then the review ordinarily should be overseen by a member of the committee at the reviewer's expense. If the reviewer has completed the fieldwork on one or more reviews prior to the imposition of the corrective or monitoring action, then the AICPA Peer Review Board will consider what action, if any, to take regarding those reviews, based on the facts and circumstances.

Qualifications of Committee Members

.92 Each member of a committee charged with the responsibility for acceptance of reviews should be—

- a. 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 an owner of the firm or as a manager or person with equivalent supervisory responsibilities.
- b. Associated with a firm that has received an unqualified report on its most recently completed peer review.

A majority of the committee members must also possess the qualifications required of an on-site peer review team captain.

Effective Date

.93 The effective date for this Standard is for peer review years beginning on or after January 1, 1997.

.94

Exhibit

Additional Requirements for Members of the Private Companies Practice Section

1. A member of the Private Companies Practice Section of the AICPA Division for CPA Firms shall comply with the section's requirement for mandatory peer review by—

- a. Having a review administered under the AICPA peer review program or, if it is or becomes a member of the SEC Practice Section of the AICPA Division for CPA Firms, a review administered by that section.
- b. Complying with all of the standards and requirements of the applicable practice-monitoring program and with any additional requirements as may be established or modified from time to time by the Private Companies Practice Executive Committee.

2. The Private Companies Practice Executive Committee has established the following additional *membership* requirements:

- a. Ensure that a super majority (66 2/3 percent) of the ownership of the firm in terms of financial interests and voting rights belongs to CPAs (firms not in compliance with this requirement have until May 1997 to ensure compliance), that the firm can legally engage in the practice of public accounting, and that each owner of the firm residing in the United States and eligible for AICPA membership is a member of the AICPA.
- b. Adhere to the quality control standards established by the AICPA.
- c. Ensure that all professionals in the firm residing in the United States, including CPAs and non-CPAs, take part in qualifying continuing professional education in one of the following ways.
 - (i) Participate in at least 120 hours every three years, but not less than twenty hours every year.
 - (ii) Comply with mandatory continuing professional education requirements for state licensing or for state CPA society membership, provided such state or society requirements require an average of forty hours per year of continuing professional education for each reporting period, and provided each professional in the firm participates in at least twenty hours every year.
- d. Pay dues as established by the executive committee, and comply with the rules and regulations of the section as established from time to time by the executive committee and with the decisions of the executive committee in respect of matters within its competence; cooperate with the committee responsible for administering the firm's peer review in connection with that committee's duties, including disciplinary matters; and comply with any sanction that may be imposed by the executive committee.

* This exhibit includes summarized information from the AICPA's PCPS publication *What You Need to Know About Membership in the Private Companies Practice Section (PCPS): Advocacy, Action, Answers*.

- e. File with the section for each fiscal year certain nonfinancial information about the firm within ninety days of the end of such fiscal year, to be open to public inspection.
3. The Private Companies Practice Executive Committee has also established the following additional peer review requirements:
 - a. Each member of a review team performing a peer review of a firm that is a section member shall be associated with a firm that is a section member. Also, the firm with which the team captain is associated shall have received an unqualified report on its most recent peer review and that report shall be placed in the public files of the AICPA Division for CPA Firms.
 - b. The report, the letter of comments, and the reviewed firm's response shall be placed in the public files of the section at AICPA headquarters. If additional actions are deemed necessary by the committee responsible for administering the firm's review, a memorandum indicating that they have been accepted with the understanding that the firm will agree to take certain actions shall also be placed in the public file. The letter setting forth those actions and the firm's agreement to undertake them shall be placed in the public file upon receipt.
 - c. The peer review shall include appropriate tests of the firm's compliance with the membership requirements of the section and the report shall include an opinion on whether the reviewed firm complied with the membership requirements of the section in all material respects and, if not, a description of the reasons for the qualification.

Appendix A

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 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 as 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 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 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 peer review commenced and that independent review was accepted by the SEC Practice Section Peer Review Committee of the AICPA Division for CPA Firms before

that date. (All quality control materials and CPE programs are accepted by the SECPS Peer Review Committee for both the SECPS and AICPA peer review programs. Therefore, firms that share materials and services are advised to consult with the SECPS peer review program 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

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

Limitation on Scope of Review

1. A qualified 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 qualifying the review report for a scope limitation should consult with the state CPA society 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 SAS No. 46, *Consideration of Omitted Procedures After the Report Date* [AU section 390], and SAS No. 1, section 561 entitled *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report* [AU section 561], the team is faced with a clear indication that, in those engagements, the firm failed to conform with professional standards. The review team's first task in such circumstances is to try to determine the cause of the failure. Causes that might be systems-related and might affect the type of report issued include the following:

- 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 state CPA society administering the review before reaching such a conclusion.

3. The failure to conform with professional standards on an engagement may be the result of an isolated human error and, therefore, does not necessarily mean that the review report should be qualified or adverse. 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 conform with professional standards on one engagement also exists in other 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 involvement in the planning process by an owner of the firm. 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 review by the owner of the firm more difficult and increases the possibility that the firm might not conform with professional standards in a significant respect, which means that the reviewer must consider carefully the need for a qualified or adverse report. 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 that should not result in a qualified or adverse report.

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 system of quality control 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 personnel management (hiring, assigning personnel to engagements, and advancement) and acceptance and continuance of clients and engagements. 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 addressed in the letter of comments.

Noncompliance With Private Companies Practice Section Membership Requirements

6. If a firm is a member of the Private Companies Practice Section, the review team is required to evaluate whether the firm complied in all material respects with each of the membership requirements of the section. Although

adherence to all membership requirements in every situation may not have been possible, a high degree of compliance is expected. In evaluating the significance of noncompliance with a membership requirement, the review team should recognize that those requirements directly related to the quality of performance on accounting and auditing engagements are more critical.

Forming Conclusions

7. 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

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

[State CPA society letterhead for a "CART Review"; firm letterhead for a "Firm-on-Firm Review"; association letterhead for an "Association Review"]

August 31, 19XX

To the Owners
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 established by the Peer Review Board of the American Institute of Certified Public Accountants (AICPA). We tested compliance with the firm's system of quality control 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 for an accounting and auditing practice issued by the AICPA. Those standards indicate that a firm's quality control policies and procedures 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 an individual's performance and understanding of professional requirements or the firm's quality control policies and procedures can affect the degree of compliance with a firm's prescribed quality control policies and procedures and, therefore, the effectiveness of the system.

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, has been designed in accordance with the quality control standards for an accounting and auditing practice established by the AICPA and was being complied with for the year then ended to provide the firm with reasonable assurance of conforming with professional standards in the conduct of that practice.

[The following paragraph should be added if the firm is a member of the Private Companies Practice Section.]

* No copy of this report or any other document related to the review will be placed in a public file unless the firm is a member of the Private Companies Practice Section. In such case, pursuant to the membership requirements of the Private Companies Practice Section, a copy of this report, the letter of comments, if any, and the firm's response thereto will be placed in the public files of the AICPA Division for CPA Firms, along with the letter from the state CPA society accepting those documents.

** The report should use the plural "we," "us," and "our" even if the review team consists of only one person. The singular "I," "me," and "my" is appropriate only when the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

[*Name of Firm*] is a member of the Private Companies Practice Section of the AICPA Division for CPA Firms (the section) and has agreed to comply with the membership requirements of the section. In connection with our review, we tested the firm's compliance with those requirements to the extent we considered appropriate. In our opinion, the firm was in conformity with the membership requirements of the section for the year ended June 30, 19XX, in all material respects.

John Brown, Team Captain

[*or Name of Reviewing Firm*]

Appendix D

Illustrations of Qualified and Adverse Reports on an On-Site Peer 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 engagement performance regarding audit planning were not appropriately designed.

[Opinion paragraph]

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

Report Qualified for Noncompliance With Quality Control Policies and Procedures

[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 engagement performance regarding completion of financial statement reporting and disclosure checklists were not followed.

[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 audit-

ing practice of *[Name of Firm]* in effect for the year ended June 30, 19XX, has not been designed in accordance with the quality control standards for an accounting and auditing practice established by the AICPA (, was not being complied with for 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.

Report Qualified for Noncompliance With the Private Companies Practice Section Membership Requirements

[Fourth paragraph after the first three paragraphs of the standard report on a firm in the Private Companies Practice Section]

[Name of Firm] is a member of the Private Companies Practice Section of the AICPA Division for CPA Firms (the section) and has agreed to comply with the membership requirements of the section. In connection with our review, we tested the firm's compliance with those requirements to the extent we considered appropriate. In our opinion, except for the failure of a significant number of professionals to participate in the required number of hours of qualifying continuing professional education, the firm was in conformity with the membership requirements of the section for the year ended June 30, 19XX, in all material respects, as discussed in our letter of comments under this date.

* If the opinion expressed on the quality control system is adverse, the opinion expressed concerning the firm's compliance with the membership requirements of the Private Companies Practice Section should also be adverse. This can be accomplished by stating in the last sentence of the fourth paragraph, "In our opinion, the firm was not in conformity with the membership requirements of the section in all material respects because it did not comply with the AICPA quality control standards for the year ended June 30, 19XX."

Appendix E

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

Guidelines

1. The objectives of the letter of comments on an on-site peer review are set forth in the Standards.

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

- 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 peer review
- c. A statement that the review was performed in accordance with standards established by the Peer Review Board of the AICPA
- d. A description of the limitations of a system of quality control
- e. A statement that the matters discussed in the letter were considered in determining the opinion on the system of quality control
- f. The findings on the review and related recommendations (This section should be separated between those findings, if any, that resulted in a qualified or adverse 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 peer review.)

3. In addition to matters that resulted in a qualified or adverse 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, or when a Private Companies Practice Section member firm has failed to comply with one or more of the section's membership requirements." 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 system of quality control 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

[*State CPA society letterhead for a "CART Review"; firm letterhead for a "Firm-on-Firm Review"; association letterhead for an "Association Review"*]

August 31, 19XX

To the Owners
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 qualified 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 (and with the membership requirements of the Private Companies Practice Section).^{**} Our review was conducted in conformity with standards established by the Peer Review Board of 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 (and with the membership requirements of the section)^{**} 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. As a result of our review, we have the following comments which were considered in determining our opinion set forth in our report dated August 31, 19XX, and this letter does not change that report.

Matters That Resulted in a Qualified Report^{***}

Engagement Performance

Finding—The firm's quality control policies and procedures do not require owner 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

^{*} This phrase should be used only if a qualified or adverse report is being issued, and it should be tailored to fit the circumstances.

^{**} This phrase should be used only if the reviewed firm is a member of the Private Companies Practice Section.

^{***} This caption should be used only if a qualified or adverse report is being issued, and it should be tailored to fit the circumstances.

supervision, by the engagement owner in planning the audit, the work performed on receivables and inventory did not appear to support the firm's opinion on the financial statements. The firm has subsequently 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 owner review of the preliminary audit plan and the audit program.

Matters That Did Not Result in a Qualified Report*

Engagement Performance

Finding—The firm's quality control policies and procedures require the completion of a financial reporting and disclosure checklist on each financial statement engagement. Our review disclosed the firm had not complied with this policy on all of the engagements reviewed. In each case where a checklist was not completed, we also found certain financial statement disclosures were missing or incomplete. None of the missing or incomplete disclosures represented significant departures from professional standards.

Recommendation—The firm should hold training courses on proper completion of its financial reporting and disclosure checklist and reemphasize its policy requiring completion of that checklist.

Monitoring

Finding—The firm's policies and procedures require that findings on engagements reviewed during the firm's annual inspection be summarized so that management can consider what types of actions, if any, are necessary. However, the firm did not summarize inspection findings from engagement reviews on the most recent inspection, even though each engagement owner considered and responded to findings on their individual engagements.

Recommendation—The firm should comply with its policy of summarizing inspection findings, considering the overall systems' implication of these findings and documenting management's monitoring of the actions taken. An owner in the firm should be designated to monitor the firm's compliance with this policy.

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

* This caption should be used only if a qualified or adverse report is being issued, and it should be tailored to fit the circumstances.

Appendix F

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

The purpose of a letter of response is to describe the actions 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 .78 through .84]). If the firm has received a qualified or adverse report, the firm's responses should be separated between those findings that resulted in a qualified or adverse report and those that did not.

Sample Letter of Response

September 15, 19XX

[Addressed to the state CPA society administering the review]

Ladies and Gentlemen:

This letter represents our response to the letter of comments issued in connection with our firm's on-site peer 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. In addition, the matters discussed in this letter will be monitored to ensure they are effectively implemented as a part of our system of quality control.

Matters That Resulted in a Qualified Report

Owner Involvement in Audit Planning—The firm modified its quality control policies and procedures to require an owner to be involved in the planning stage of all audit engagements. In addition, we identified review engagements that are sufficiently large or complex to warrant owner involvement in the planning stage. The revised policies and procedures require the engagement owner 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 owner involvement, to quality work was emphasized in the training session referred to above.

Matters That Did Not Result in a Qualified Report

Financial Reporting and Disclosure Checklists—All professional personnel were reminded of the importance of complying with the firm's policy requiring

* This caption should be used only if a qualified or adverse report is being issued, and it should be tailored to fit the circumstances.

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 owner to document his or her review of the completed checklist. (The engagement review questionnaire is a brief form completed by the engagement owner and the manager at the conclusion of an audit to document their completion of their assigned responsibilities.)

Monitoring—An owner of the firm has been designated as responsible for summarizing the findings on the firm's annual inspection and monitoring the actions taken as a result of those findings to prevent their recurrence.

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

Sincerely,

[Name of Firm]

Appendix G

Considerations Governing the Type of Report Issued on an Off-Site Peer Review

Circumstances Calling for a Qualified Report

1. The objective of an off-site peer review is to provide the reviewer with a reasonable basis for expressing limited assurance that the financial statements or information and the related accountant's report on accounting and review engagements and attestation engagements submitted for review, conform in all material respects with 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 peer 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, if 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 report on an accounting or review engagement 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 on financial statements prepared on an other comprehensive basis of accounting that does not disclose the basis of accounting in the report or in a note to the financial statements.
- c. The issuance of a report on an attestation engagement that is misleading in the circumstances. An example might include a review report that does not disclose the criteria against which the assertion was measured.
- d. Other departures from professional standards, noted in a significant number of engagements submitted for review, that individually may not be considered a significant departure from professional standards but that collectively (or in the aggregate) would warrant the issuance of a qualified report. In reaching this decision, the reviewer should consider the significance and pervasiveness of the departures from professional standards.

2. The objective of an off-site peer review of a member of the Private Companies Practice Section is also to provide the reviewer with a reasonable basis for expressing limited assurance that the firm has complied with the membership requirements of the section in all material respects.

Circumstances Calling for an Adverse Report

3. As indicated in these Standards, an off-site peer review does not provide the reviewer with a basis for expressing any form of assurance on the reviewed firm's system of quality control. Therefore, deciding whether the findings of an off-site peer review support an adverse conclusion requires the careful exercise of professional judgment. In reaching a decision, the reviewer would ordinarily consider the significance of the departures from professional standards, as described above, that were disclosed by the review and the pervasiveness of such departures. In that connection, the reviewer needs to give appropriate weight to the fact that the report on an off-site review only addresses conformity with professional standards and not the system of quality control.

Other Departures That May Require Disclosure

4. 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 letter of comments (see appendix J [paragraph .104]).

Appendix H

Standard Form for an Unqualified Report on an Off-Site Peer Review

[State CPA society letterhead for a "CART Review"; firm letterhead for a "Firm-on-Firm Review"; association letterhead for an "Association Review"]

August 31, 19XX

To the Owners
Able, Baker & Co.

or

To John B. Able, CPA

We** have performed an off-site peer 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 Peer Review Board of the American Institute of Certified Public Accountants (AICPA). *[Name of Firm]* has represented to us that the firm performed no services under the Statements on Auditing Standards or examinations of prospective financial statements under the Statements on Standards for Attestation Engagements during the year ended June 30, 19XX.

An off-site peer review consists only of reading selected financial statements or information and the accountant's report thereon, together with certain representations provided by the firm, for the purpose of considering whether the financial statements or information and the accountant's report appear to be in conformity with professional standards. An off-site peer review does not provide the reviewer with a basis for expressing any assurance as to the firm's system of quality control for its accounting practice, and we express no opinion or any form of assurance on that system.

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

[The following paragraph should be added if the firm is a member of the Private Companies Practice Section.]

[Name of Firm] is a member of the Private Companies Practice Section of the AICPA Division for CPA Firms (the section) and has agreed to comply with the

* No copy of this report or any other document related to the review will be placed in a public file unless the firm is a member of the Private Companies Practice Section. In such case, pursuant to the membership requirements of the Private Companies Practice Section, a copy of this report, the letter of comments, if any, and the firm's response thereto will be placed in the public files of the AICPA Division for CPA Firms, along with the letter from the state CPA society accepting those documents.

** The report should use the plural "we," "us," and "our" even if the review team consists of only one person. The singular "I," "me," and "my" is appropriate only when the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

membership requirements of the section. In connection with our review, we tested the firm's compliance with those requirements to the extent we considered appropriate. Nothing came to our attention that caused us to believe that the firm did not conform with the membership requirements of the section for the year ended June 30, 19XX, 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 peer reviews.

Appendix I

Illustrations of Other Types of Reports on an Off-Site Peer Review

[See appendix H [paragraph .102] for information about applicable letterhead and about addressing and signing the report]

Qualified Report for Significant Departures From Professional Standards

[Separate paragraph, after the standard first two paragraphs, describing the significant matters that resulted in a qualified report]

As discussed in our letter of comments under this date, our review disclosed that 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, significant financial statement disclosure deficiencies concerning related-party transactions were noted in several of the engagements reviewed.

[Concluding paragraph]

In connection with our off-site peer review, with the exception of the matter(s) described in the preceding paragraph, nothing came to our attention that caused us to believe that the reports submitted for review by *[Name of Firm]* for the year ended June 30, 19XX, did not conform with the requirements of professional standards in all material respects.

Adverse Report

[Separate paragraph, after the standard first two paragraphs, describing the significant matters that resulted in an adverse report]

However, 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 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 revenue 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.

[Adverse concluding paragraph]

Because of the significance of the matters described in the preceding paragraph, we do not believe that the reports submitted for review by *[Name of Firm]* for the year ended June 30, 19XX, conform with the requirements of professional standards in all material respects.

Qualified Report for Noncompliance With the Private Companies Practice Section Membership Requirements*

[Fourth paragraph, after the standard first three paragraphs, describing the noncompliance with the applicable membership requirement]

[Name of Firm] is a member of the Private Companies Practice Section of the AICPA Division for CPA Firms (the section) and has agreed to comply with the membership requirements of the section. In connection with our review, we tested the firm's compliance with those requirements to the extent we considered appropriate. Except for the failure of a significant number of professionals to participate in the required number of hours of qualifying continuing professional education, nothing came to our attention that caused us to believe that the firm did not conform with the membership requirements of the section for the year ended June 30, 19XX, in all material respects, as discussed in our letter of comments under this date.

* If the report on the accounting practice is adverse, the report on the firm's compliance with the membership requirements of the Private Companies Practice Section should also be adverse. This can be accomplished by stating in the last sentence of the fourth paragraph, "We believe the firm was not in conformity with the membership requirements of the section in all material respects because it did not comply with the AICPA quality control standards for the year ended June 30, 19XX."

Appendix J

Guidelines for and Illustration of a Letter of Comments on an Off-Site Peer Review

Guidelines

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

2. The letter should be addressed, dated, and signed in the same manner as the report on the off-site peer review, and should include the following:

- 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 off-site peer review
- c. A statement that the review was performed in accordance with standards established by the Peer Review Board of the AICPA
- d. A statement that the matters discussed in the letter were considered in preparing the report
- e. The findings on the review and related recommendations (This section should be separated between those findings, if any, that resulted in a qualified or adverse 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 peer review.)

3. In addition to matters that resulted in a qualified or adverse report, which must always be included in the letter, the letter of comments should include the following:

- a. 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
- b. Instances in which the firm failed to comply with one or more of the membership requirements of the Private Companies Practice Section in all material respects, but the instances are not deemed to be significant enough to qualify the report

Illustration of a Letter of Comments

[State CPA society letterhead for a "CART Review"; firm letterhead for a "Firm-on-Firm Review"; association letterhead for an "Association Review"]

August 31, 19XX

To the Owners
Able, Baker & Co.

or

To John B. Baker, CPA

We have performed an off-site peer 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 Peer Review Board of the American Institute of Certified Public Accountants (AICPA), and have issued our report thereon dated August 31, 19XX (which was qualified/adverse* as described therein). This letter should be read in conjunction with that report.

An off-site peer review consists only of reading selected financial statements or information and the accountant's report thereon, together with certain representations provided by the firm, for the purpose of considering whether the financial statements or information and the accountant's report appear to be in conformity with professional standards. An off-site peer review does not provide the reviewer with a basis for expressing any assurance as to the firm's system of quality control for its accounting practice, and we express no opinion or any form of assurance on that system. However, the following matters, which were considered in preparing our report dated August 31, 19XX, did come to our attention during our review and this letter does not change that report:

Matters That Resulted in a Qualified Report**

1. **Finding**—During our review, we noted that the firm did not qualify its reports on financial statements when neither the financial statements nor the footnotes noted that the statements were presented on a comprehensive basis of accounting other than generally accepted accounting principles.

Recommendation—We recommend that the firm review the reports issued during the last year and identify those reports that should have been modified to reflect a comprehensive basis of accounting other than generally accepted accounting principles. A memorandum should then be prepared highlighting the changes to be made in the current year and placed in the files of the client for whom a report must be changed.

2. **Finding**—In the engagements that we reviewed, disclosures of related-party transactions and lease obligations as required by generally accepted accounting principles were not included in the financial statements, and the omission was not disclosed in the accountant's reports.

Recommendation—We recommend that the firm review the professional standards governing disclosures of related-party transactions and lease obligations and disseminate information regarding the disclosure requirements to all

* To be included if the reviewer issues a qualified or adverse report. The wording should be tailored to fit the circumstances.

** This caption is to be used only if a qualified or adverse report has been issued, and it should be tailored to fit the circumstances.

staff involved in reviewing or compiling financial statements. In addition, we recommend that the firm establish appropriate policies to ensure that all necessary related-party transactions and lease obligations are disclosed in financial statements reported on by the firm. For example, a step might be added to compilation and review work programs requiring that special attention be given to these areas.

3. *Finding*—During our review of the accountants' reports issued by the firm, we noted numerous instances in which the accompanying financial statements departed from professional standards and on which the accountants' reports were not appropriately qualified. These included the following:

- Failure to disclose material intercompany transactions
- Failure to appropriately recognize revenue
- Failure to present financial statements in a proper format
- Failure to recognize conflicting or incorrect information within the financial statements presented

In one instance, the firm has discussed the departures with its client and decided to recall its report and restate the accompanying financial statements.

Recommendation—We recommend that the firm establish a means of ensuring its compliance with professional standards on accounting engagements. Such means might include continuing professional education in accounting and reporting, use of a reporting and disclosure checklist on accounting engagements, or a "cold" review of reports and financial statements prior to issuance.

4. *Finding*—On substantially all the engagements that we reviewed, we noted that the firm did not comply with the AICPA Statements on Standards for Accounting and Review Services for reporting on comparative financial statements and going concern issues.

Recommendation—We recommend that the firm review the requirements for reporting on comparative financial statements and revise the standard reports used by the firm to conform with these requirements. Also, the firm should review the requirements governing reporting on going concern issues and provide guidance to the staff in this area.

Matters That Did Not Result in a Qualified Report

5. *Finding*—During our review of computer-generated compiled financial statements prepared by the firm, we noted that the firm failed to indicate the level of responsibility it was taking for supplemental data presented with the basic financial statements.

Recommendation—The firm should revise the standard reports used by the firm to conform with professional standards governing reporting on supplemental data presented with basic financial statements.

6. *Finding*—We noted that computer-generated compiled financial statements prepared on a basis of accounting other than generally accepted accounting principles (GAAP) were properly reported on, but they used titles normally associated with a GAAP presentation.

* This caption is to be used only if a qualified or adverse report has been issued, and it should be tailored to fit the circumstances.

Recommendation—The firm should review the professional standards governing the titles to be used when financial statements are prepared on a comprehensive basis of accounting other than GAAP and make sure that the software used by the firm is adjusted to conform with these standards. Until the software is revised, the firm should manually prepare the compiled financial statements in accordance with professional standards.

[*Same signature as on the report on the off-site peer review*]

Appendix K

Illustration of a Response by a Reviewed Firm to a Letter of Comments on an Off-Site Peer Review

The purpose of a letter of response is to describe the actions 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 .78 through .84]). If the firm has received a qualified or adverse report, the firm's responses should be separated between those findings that resulted in a qualified or adverse report and those that did not.

Sample Letter of Response

September 15, 19XX

[Addressed to the state CPA society administering the review]

Ladies and Gentlemen:

This letter represents our* response to the letter of comments on the off-site peer review of our firm's accounting practice for the year ended June 30, 19XX.

To prevent the recurrence of the disclosure deficiencies noted by the reviewer and to prevent other disclosure deficiencies from occurring, we have obtained copies of the AICPA reporting and disclosure checklists. These checklists will be completed on all review engagements and on all compilation engagements.

We have established procedures to ensure that our reports and the computer-generated compiled financial statements prepared on a basis of accounting other than generally accepted accounting principles reflect the appropriate titles.

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

Sincerely,

[Name of Firm]

[The next page is 17,801.]

* The response should use the singular "I," "me," and "my" only when the reviewed firm is a sole practitioner.

PR Section 100A***Standards for Performing and Reporting on Peer Reviews (Effective for Peer Review Years Beginning Before January 1, 1997)*****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 owners or employees of firms enrolled in an approved practice-monitoring program in order to retain their membership in the Institute beyond specified periods.

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

In the fall of 1994, the AICPA Board of Directors and the AICPA Council approved the combination of the peer review program of the private companies practice section and the AICPA quality review program. At that time, the AICPA quality review program was renamed the AICPA peer review program and the executive committee, having senior status with authority to establish and conduct the review program in cooperation with state CPA societies, was renamed the AICPA Peer Review Board.

These standards are effective for reviews performed on or after April 3, 1995, of firms enrolled in the AICPA peer review program and of firms that are members of the private companies practice section. They are applicable to firms enrolled in these programs and to individuals and firms who perform and report on such reviews, to state CPA societies administering the reviews, and to associations of CPA firms assisting their members in arranging and carrying out peer reviews. Individuals using these standards should be knowledgeable about interpretations issued by the AICPA Peer Review Board which might impact the application of these standards.

Reviews of firms that are members of the SEC practice section of the AICPA Division for CPA Firms are carried out under the standards issued by the SEC practice section's peer review committee that address, among other things, the various membership requirements of the section applicable to audits of SEC clients.

Introduction

.01 Quality in the performance of accounting and auditing engagements by AICPA members is the goal of the AICPA peer 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 AICPA peer 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.
- d. Take remedial, corrective actions as needed.

.03 Statement on Quality Control Standards (SQCS) No. 1, *System of Quality Control for a CPA Firm*,* 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 AICPA peer 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) have on-site peer reviews, while firms that provide only compilation or review services have off-site peer reviews of selected reports on those services, unless they elect to have on-site peer reviews. Firms that do not provide those services are not reviewed.

.05 Upon completing a peer review, the review team prepares a written report and, when applicable, a letter of 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 state CPA society administering its review. These documents are not public documents, unless the firm is a member of the private companies practice section of the AICPA Division for CPA Firms. However, the reviewed firm may make them available to the public if it so chooses after they have been formally accepted by the state CPA society administering the review.

.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 co-

* SQCS No. 1 was superseded by SQCS No. 2, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice* [QC section 20], effective as of January 1, 1997. [Footnote revised, July 1997, by issuance of Statement on Quality Control Standards No. 2.]

operation. 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 enrollment in the peer review program or membership in the private companies practice section (PCPS) of the AICPA Division for CPA Firms, and the subsequent loss of membership in the AICPA by its owners and 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 owners of a firm that seeks to be enrolled in the AICPA peer review program must be a member of the AICPA.¹

Confidentiality

.08 A peer 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 peer reviews are undertaken.² In all cases, the reviewed firm may advise its clients that it will have a peer 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 .79] apply.

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

¹ Exhibit 1 [paragraph .78] includes summarized information from Section 1000 of the *PCPS Reference Manual*, "Organizational Structure and Functions of the Private Companies Practice Section," concerning the private companies practice section membership requirements and additional peer review requirements.

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.

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 peer 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 peer review program must be carried out in conformity with these standards under the supervision of a state CPA society authorized by the AICPA Peer Review Board to administer peer reviews. This imposes an obligation on reviewed firms to arrange and schedule their reviews in compliance with the administrative procedures established by the applicable state CPA society, and to cooperate with the society and with the AICPA Peer Review Board 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-on-firm review) or by a state CPA society participating in the program (a committee-appointed review team). Also, the AICPA Peer Review Board may authorize an association of CPA firms to assist its members by organizing review teams to carry out on-site and off-site peer 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, communicating the review team's findings to the reviewed firm and to the state CPA society administering the review,³ and preparing the report and, if applicable, the letter of comments on the review. Team captains on on-site and off-site peer reviews should test the work performed by other reviewers to the extent deemed necessary in the circumstances.

Qualifications for Service as a Reviewer

General

.17 Performing and reporting on peer reviews requires the exercise of professional judgment by peers. Accordingly, an individual serving as a reviewer

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

(whether for on-site or off-site peer reviews)⁴ must be a member of the AICPA licensed to practice as a certified public accountant, must possess current knowledge of applicable professional standards, and 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 (that is, a firm enrolled in the AICPA peer review program or a firm that is a member of the AICPA Division for CPA Firms) as one of the following:

- a. An owner of the firm
- b. A manager or person with equivalent supervisory responsibilities

On-Site Peer Reviews

.18 All on-site review team members must have at least five years of recent experience in the practice of public accounting in the accounting and auditing function.⁵ A team captain must be an owner of an enrolled firm and must have completed a training course or courses that meet requirements established from time to time by the AICPA Peer Review Board. 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. 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 peer 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 Peer Reviews

.21 All reviewers participating in off-site peer reviews (available to firms that perform no audits of historical or prospective financial statements) should have had at least five years of recent experience in the practice of public accounting in the accounting or auditing function⁶ and must have completed a training course or courses that meet requirements established from time to time by the AICPA Peer Review Board. Off-site reviewers must also be associated with a firm that has received, within the three previous years, either of the following:

- a. An unqualified report on its system of quality control

⁴ See exhibit 1 [paragraph .78] for additional qualifications needed by individuals performing reviews of firms in the private companies practice section.

⁵ The Peer Review Board 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 peer review with professional expertise.

⁶ See footnote 5.

- b. A report on an off-site review that is not adverse or qualified for significant departures from professional standards

Performing On-Site Peer Reviews

Objectives

.22 An on-site peer 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 (SQCS) No. 1^{*}).
- 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.
- c. If applicable, the reviewed firm was complying with the membership requirements of the private companies practice section of the AICPA Division for CPA Firms in all material respects. (See exhibit 1 [paragraph .78] for a description of the membership requirements.)

.23 Firms that perform audits of historical or prospective financial statements must have on-site peer 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 peer 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. If the reviewed firm is a member of the private companies practice section, the review also should include a review of the firm's compliance with the section's membership requirements. (See exhibit 1 [paragraph .78].) Ordinarily, the review year must not end before the end of the previous calendar year.

.25 Statement on Quality Control Standards (SQCS) No. 1^{*} 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 re-

^{*} SQCS No. 1 was superseded by SQCS No. 2, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice* [QC section 20], effective as of January 1, 1997. [Footnote revised, July 1997, by issuance of Statement on Quality Control Standards No. 2.]

spect 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 Peer Review Board. 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 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 for this purpose 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 peer 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 .56 through .68]).
- 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 .56 through .68]).

- e. Appropriate consideration of the results of the review by a duly constituted committee of a participating state CPA society. 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 .69 through .76]).

.28 The AICPA Peer Review Board 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 peer 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 peer reviews under these standards, is limited to all engagements covered by Statements on Auditing Standards, Statements on Standards for Accounting and Review Services, the Statement on Standards for Attestation Engagements *Financial Forecasts and Projections* [AT section 200], 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 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 report on the last review of the firm and, if applicable, the letter of comments and the response thereto, and the letter accepting those documents. The team captain should consider whether the matters discussed in those documents 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 peer re-

view report should be modified in these circumstances should consult with the state CPA society 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 with 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*,* and in the program for reviewers issued by the AICPA Peer Review Board. 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, assist 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 last review of the firm, 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 Peer Review Board 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,

* *Establishing Quality Control Policies and Procedures* was superseded by the nonauthoritative *Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, effective as of January 1, 1997.

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 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 state CPA society administering the review about any requirements of relevant state boards of accountancy that must be met for the review to be accepted by such state board(s) as the equivalent of one performed under the state 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, brokers and dealers in securities, and employee benefit plans
- 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*.⁷

.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

⁷ Reviewers should be alert to peer review standards interpretations [section 9100A] developed by the Peer Review Board that might affect the engagements selected for review.

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 state CPA society 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 by the state CPA society administering the review to refer unresolved matters to the AICPA Peer Review Board 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 individuals 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 Peer Reviews

Objectives

.49 The objective of an off-site peer 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 peer review in recognition of the fact that off-site peer reviews are available only to firms that perform review or compilation engagements but perform no audits of historical or prospective financial statements. An accountant's review report 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 peer review unless they elect to have an on-site peer review. However, this does not relieve such firms from their obligation to have a system of quality control (see paragraph .03). Compliance with the positive enforcement program of a state board of accountancy does not constitute compliance with the AICPA practice-monitoring requirement.

Basic Requirements

.50 The reviewed firm shall provide summarized information showing the number of its review or compilation clients and the nature of the service provided to those clients, classified into major industry categories. That information shall be provided for each owner of the firm who is responsible for the issuance of review or compilation reports. On the basis of that information, the reviewer or the state CPA society administering the review ordinarily 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 owner of the firm 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* above, 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 reports, masking client identity if it desires, along with specified background information and representations about each engagement. If the reviewed firm is a member of the private companies practice section, the reviewed firm shall also submit information concerning its compliance with the section's membership requirements. (See exhibit 1 [paragraph .78].)

.51 An off-site peer 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 peer 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 peer review.

.52 Accordingly, an off-site peer 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.

.53 A firm that has an off-site peer 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.

.54 Although an off-site peer 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 peer review within twelve months.

.55 The reviewer performing an off-site peer review must document the work performed using the programs and checklists issued by the AICPA Peer Review Board 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 peer review program.

Reporting on Reviews

General

.56 Within thirty days of the date of the exit conference or the date of completion of an off-site peer 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 state CPA society administering the review. The report on an on-site peer review ordinarily should be dated as of the date of the exit conference. The report on an off-site peer review ordinarily should be dated as of the completion of the review procedures.

.57 The team captain or, where provided by its plan of administration, an authorized association of CPA firms should notify the state CPA society administering the review that the review has been completed and should submit to that state CPA society 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 Peer Review Board.

.58 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 state CPA society administering the review within thirty days of the date it received the report and letter.

.59 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 as meeting the requirements of the AICPA peer review program. Neither the state CPA society nor the AICPA shall make the results of the review available to the public,⁸ but may disclose on request the following information:

- a. The firm's name and address
- b. The firm's participation in the peer 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 Peer Reviews

.60 The written report on an on-site peer review should indicate the scope of the review, including any limitations thereon; a description of the general

⁸ If the firm is a member of the private companies practice section, the section's membership requirements provide that a copy of the report, letter of comments, if any, and the firm's response thereto be placed in the public files of the AICPA Division for CPA Firms. (See exhibit 1 [paragraph .78].)

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 qualification of the opinion. If the reviewed firm is a member of the private companies practice section, the report should also indicate whether the firm complied with the membership requirements of the section in all material respects and a description of the reason(s) for any qualification.

.61 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 .80]. The standard form for an unqualified report is illustrated in appendix C [paragraph .81]. Illustrations of qualified and adverse reports are presented in appendix D [paragraph .82].

Reports on Off-Site Peer Reviews

.62 The written report on an off-site peer 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. If the reviewed firm is a member of the private companies practice section, the report should also state whether anything came to the reviewer's attention that caused the reviewer to believe the firm was not complying with the section's membership requirements.

.63 In deciding on the type of report to be issued, the reviewer should be guided by the considerations in appendix G [paragraph .85]. The standard form for an unqualified report on an off-site peer review is illustrated in appendix H [paragraph .86]. Illustrations of other types of reports are presented in appendix I [paragraph .87].

Letters of Comments

.64 A letter of comments is required to be issued in connection with an on-site peer review when there are matters that resulted in a modification 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, or when a private companies practice section member firm has failed to comply with one or more of the section's membership requirements. 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 can evaluate whether the firm's response to the findings noted in the review is a positive one consistent with

the objectives of the peer review program and whether the actions taken or planned by the firm appear appropriate in the circumstances.

.65 The letter of comments on an on-site peer review should be prepared in accordance with the guidance and illustrations in appendix E [paragraph .83]. An illustration of a response by a reviewed firm is included in appendix F [paragraph .84].

.66 A letter of comments is required to be issued in connection with an off-site peer review when there are matters that resulted in qualification(s) to the standard form of report or when the reviewer notes 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, or when a private companies practice section member firm has failed to comply with one or more of the section's membership requirements. Such a letter should provide reasonably detailed descriptions of the findings and recommendations so that the state CPA society administering the review can evaluate whether the actions taken or planned by the firm appear appropriate in the circumstances.

.67 In writing a letter of comments on an off-site peer review, consideration should be given to the guidance and illustrations in appendix J [paragraph .88]. An illustration of a response by a reviewed firm is included in appendix K [paragraph .89].

.68 When a letter of comments is issued along with a qualified or adverse report on an on-site or off-site peer review, 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

.69 A committee or committees should be appointed by each participating state CPA society for the purpose of considering the results of reviews it administers that are undertaken to meet the requirements of the peer review program. The activities of such committees (hereafter, the committee) should be carried out in accordance with administrative procedures issued by the AICPA Peer Review Board.

.70 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 individuals to obtain specified types and amounts of continuing professional education, requiring the firm to carry out a more comprehensive inspection program, 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 peer reviews are other examples of monitoring procedures.

.71 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.

.72 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 Peer Review Board for final resolution. In these circumstances, the AICPA Peer Review Board may consult with representatives of AICPA technical or ethical committees or with appropriate AICPA staff.

.73 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 peer 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.

.74 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 Peer Review Board may take actions, pursuant to due process procedures that it has established, leading to the termination of the firm's enrollment or participation in the AICPA peer review program.⁹

.75 If a decision is made to terminate a firm's enrollment in the AICPA peer review program, 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

⁹ Appendix A to the organizational structure and functions document of the private companies practice section (see *PCPS Reference Manual*, section 1000) contains provisions for automatically dropping or terminating the membership of firms in the private companies practice section that fail to meet certain requirements related to their peer review.

AICPA peer review program has been terminated shall be reported in an AICPA membership periodical.

.76 If a decision is made to terminate the participation of a PCPS member firm in the AICPA peer review program, that fact shall be reported to the private companies practice section for action leading to the termination of the firm's membership in the private companies practice section. Under the organizational structure and functions document of the section, the firm can appeal to the Private Companies Practice Executive Committee for a review of the findings.

Qualifications of Committee Members

.77 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 an owner of the firm or as a manager or person with equivalent supervisory responsibilities. A majority of the members must also possess the qualifications required of on-site peer review team captains. A member may not participate in any discussion or have any vote with respect to a reviewed firm when the member lacks independence or has a conflict of interest with the firm.

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Exhibit 1

Additional Requirements for Members of the Private Companies Practice Section

1. Effective April 3, 1995, a member of the private companies practice section of the AICPA Division for CPA Firms shall comply with the section's requirement for mandatory peer review by—
 - a. Having a review administered under the AICPA peer review program or, if it is or becomes a member of the SEC practice section of the AICPA Division for CPA Firms, a review administered by that section.
 - b. Complying with all of the standards and requirements of the applicable practice-monitoring program and with any additional requirements as may be established or modified from time to time by the Private Companies Practice Executive Committee.
2. The Private Companies Practice Executive Committee has established the following additional *membership* requirements.
 - a. Ensure that the firm complies with rule 505 [ET section 505.01] of the AICPA Code of Professional Conduct and related implementing resolutions of Council, that it can legally engage in the practice of public accounting, and that each owner of the firm eligible for AICPA membership is a member of the AICPA.
 - b. Adhere to the quality control standards established by the AICPA.
 - c. Ensure that all professionals in the firm residing in the United States, including CPAs and non-CPAs, take part in qualifying continuing professional education as follows:
 - (i) Participate in at least 120 hours every three years, but not less than 20 hours every year, or
 - (ii) Comply with mandatory continuing professional education requirements for state licensing or for state CPA society membership, provided such state or society requirements require an average of 40 hours per year of continuing professional education for each reporting period, and provided each professional in the firm participates in at least 20 hours every year.
 - d. Pay dues as established by the executive committee, and comply with the rules and regulations of the section as established from time to time by the executive committee and with the decisions of the executive committee in respect of matters within its competence; cooperate with the committee responsible for administering the firm's peer review in connection with that committee's duties, including disciplinary matters; and comply with any sanction which may be imposed by the executive committee.

* This exhibit includes summarized information from Section 1000 of the *PCPS Reference Manual* entitled "Organizational Structure and Functions of the Private Companies Practice Section."

- e. File with the section for each fiscal year certain nonfinancial information about the firm within 90 days of the end of such fiscal year, to be open to public inspection.
3. The Private Companies Practice Executive Committee has also established the following additional *peer review* requirements:
- a. Each member of a review team performing a peer review of a firm that is a section member shall be associated with a firm that is a section member. Also, the firm with which the team captain is associated shall have received an unqualified report on its most recent peer review and that report shall have covered the firm's compliance with the section's membership requirements.
 - b. The report, the letter of comments, and the reviewed firm's response shall be placed in the public files of the section at AICPA headquarters. If additional actions are deemed necessary by the committee responsible for administering the firm's review, a memorandum indicating that they have been accepted with the understanding that the firm will agree to take certain actions shall also be placed in the public file. The letter setting forth those actions and the firm's agreement to undertake them shall be placed in the public file upon receipt.
 - c. The peer review shall include appropriate tests of the firm's compliance with the membership requirements of the section and the report shall include an opinion on whether the reviewed firm complied with the membership requirements of the section in all material respects and, if not, a description of the reasons for the qualification.

Appendix A

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 peer review commenced and that independent review was accepted by the AICPA Peer Review Board or the relevant state CPA society (or the SEC Practice Section 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 Peer 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

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

Limitation on Scope of Review

1. A qualified 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 qualifying the review report for a scope limitation should consult with the state CPA society 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 SAS No. 46, *Consideration of Omitted Procedures After the Report Date* [AU section 390], and SAS No. 1, section 561 entitled *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report* [AU section 561], the team is faced with a clear indication that, in those engagements, the firm failed to conform 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 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 state CPA society administering the review before reaching such a conclusion.

3. The failure to conform with professional standards on an engagement may be the result of an isolated human error and, therefore, does not necessarily mean that the review report should be qualified or adverse. 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 conform with professional standards on one engagement also exists in other 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 involvement in the planning process by an owner of the firm. 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 review by the owner of the firm more difficult and increases the possibility that the firm might not conform with professional standards in a significant respect, which means that the reviewer must consider carefully the need for a qualified or adverse report. 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 that should not result in a qualified or adverse report.

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.

Noncompliance With Private Companies Practice Section Membership Requirements

6. If a firm is a member of the private companies practice section, the review team is required to evaluate whether the firm complied in all material respects with each of the membership requirements of the section. While ad-

herence to all membership requirements in every situation may not have been possible, a high degree of compliance is expected. In evaluating the significance of noncompliance with a membership requirement, the review team should recognize that those requirements directly related to the quality of performance on accounting and auditing engagements are more critical.

Forming Conclusions

7. 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.

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Appendix C

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

Firm in the AICPA Peer Review Program*

[State CPA society letterhead for a "CART Review"; firm letterhead for a "Firm-on-Firm Review"; association letterhead for an "Association Review"]

August 31, 19XX

To the Owners
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 established by the Peer Review Board of the American Institute of Certified Public Accountants (AICPA). 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]

* No copy of this report or any other document related to the review will be placed in a public file.

Firm in the Private Companies Practice Section*

[State CPA society letterhead for a "CART Review"; firm letterhead for a "Firm-on-Firm Review"; association letterhead for an "Association Review"]

August 31, 19XX

To the Owners
Smith, Jones & Co.

or

To John R. Smith, 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 established by the Peer Review Board of the American Institute of Certified Public Accountants (AICPA). 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.

[Name of Firm] is a member of the private companies practice section of the AICPA Division for CPA Firms (the section) and has agreed to comply with the membership requirements of the section. In connection with our review, we tested the firm's compliance with those requirements to the extent we considered appropriate. In our opinion, the firm was in conformity with the membership requirements of the section during the year ended June 30, 19XX, in all material respects.

John Brown, Team Captain

[or Name of Reviewing Firm]

* Pursuant to the membership requirements of the private companies practice section, a copy of this report, the letter of comments, if any, and the firm's response thereto will be placed in the public files of the AICPA Division for CPA Firms, along with the letter from the state CPA society accepting those documents.

Appendix D

Illustrations of Qualified and Adverse Reports on an On-Site Peer 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 With Quality Control Policies and Procedures

[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 au-

ding 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.

Report Qualified for Noncompliance With the Private Companies Practice Section Membership Requirements

[Fourth paragraph after the first three paragraphs of the standard report on a firm in the private companies practice section]

[Name of Firm] is a member of the private companies practice section of the AICPA Division for CPA Firms (the section) and has agreed to comply with the membership requirements of the section. In connection with our review, we tested the firm's compliance with those requirements to the extent we considered appropriate. In our opinion, except for the failure of a significant number of professionals to participate in the required number of hours of qualifying continuing professional education, the firm was in conformity with the membership requirements of the section during the year ended June 30, 19XX, in all material respects, as discussed in our letter of comments under this date.

* If the opinion expressed on the quality control system is adverse, the opinion expressed concerning the firm's compliance with the membership requirements of the private companies practice section should also be adverse. This can be accomplished by stating in the last sentence of the fourth paragraph that "the firm was not in conformity with the membership requirements of the section in all material respects because it did not comply with the AICPA quality control standards for the year ended June 30, 19XX."

Appendix E

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

Guidelines

1. The objectives of the letter of comments on an on-site peer 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 peer 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 peer review.
- c. A statement that the review was performed in accordance with standards established by the Peer Review Board of 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 qualified or adverse 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 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 qualified or adverse 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, or when a private companies practice section member firm has failed to comply with one or more of the section's membership requirements." 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

[State CPA society letterhead for a "CART Review"; firm letterhead for a "Firm-on-Firm Review"; association letterhead for an "Association Review"]

August 31, 19XX

To the Owners
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 qualified 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 and with the membership requirements of the private companies practice section.[†] Our review was conducted in conformity with standards established by the Peer Review Board of 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 [and with the membership requirements of the section][†] 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. As a result of our review, we have the following comments:

Matters That Resulted in a Qualified Report^{††}

Supervision

Finding—The firm's quality control policies and procedures do not require owner 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 owner in planning the audit, the work performed on receivables and inventory did not appear to support the firm's op-

^{*} This phrase should be used only if a qualified or adverse report is being issued, and it should be tailored to fit the circumstances.

[†] These phrases should be used only if the reviewed firm is a member of the private companies practice section.

^{††} This caption should be used only if a qualified or adverse report is being issued, and it should be tailored to fit the circumstances.

inion 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 owner review of the preliminary audit plan and the audit program.

Matters That Did Not Result in a Qualified Report

Supervision

Finding—The firm's quality control policies and procedures require the completion of a financial reporting and disclosure checklist on each financial statement engagement. Our review disclosed the firm had not complied with this policy on all of the engagements reviewed. In each case where a checklist was not completed, we also found certain financial statement disclosures were missing or incomplete. None of the missing or incomplete disclosures represented significant departures from professional standards.

Recommendation—The firm should hold training courses on proper completion of its financial reporting and disclosure checklist and reemphasize its policy requiring completion of that checklist.

Consultation

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 peer review]

* This caption should be used only if a qualified or adverse report is being issued, and it should be tailored to fit the circumstances.

Appendix F

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

The purpose of a letter of response is to describe the actions 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 .69 through .76]). If the firm has received a qualified or adverse report, the firm's responses should be separated between those findings that resulted in a qualified or adverse report and those that did not.

* * * *

Sample Letter of Response

September 15, 19XX

[Addressed to the state CPA society administering the review]

Ladies and Gentlemen:

This letter represents our response to the letter of comments issued in connection with our firm's on-site peer 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. In addition, the matters discussed in this letter will be monitored to ensure they are effectively implemented as a part of our quality control system.

Matters That Resulted in a Qualified Report*

Owner Involvement in Audit Planning—The firm modified its quality control policies and procedures to require an owner to be involved in the planning stage of all audit engagements. In addition, we identified review engagements that are sufficiently large or complex to warrant owner involvement in the planning stage. The revised policies and procedures require the engagement owner 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 owner involvement, to quality work was emphasized in the training session referred to above.

Matters That Did Not Result in a Qualified Report*

Financial Reporting and Disclosure Checklists—All professional personnel were reminded of the importance of complying with the firm's policy requiring

* This caption should be used only if a qualified or adverse report is being issued, and it should be tailored to fit the circumstances.

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 owner to document his or her review of the completed checklist. (The engagement review questionnaire is a brief form completed by the engagement owner 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.

* * * *

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

Sincerely,

[Name of Firm]

Appendix G

Considerations Governing the Type of Report Issued on an Off-Site Peer Review

Circumstances Calling for a Qualified Report

1. The objective of an off-site peer 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 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; 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.
- c. The issuance of a compilation report that is misleading in the circumstances. Examples might include a report on compiled financial statements that omit substantially all disclosures required by generally accepted accounting principles that does not clearly indicate the omission in the report; or a compilation report on financial statements prepared on an other comprehensive basis of accounting that does not disclose the basis of accounting in the report or in a note to the financial statements.

2. The objective of an off-site peer review of a member of the private companies practice section is also to provide the reviewer with a reasonable basis for expressing limited assurance that the firm has complied with the membership requirements of the section in all material respects.

Circumstances Calling for an Adverse Report

3. As indicated in these Standards, an off-site peer 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 peer review support the conclusion requires the careful exercise of professional judgment. In reaching a decision, the reviewer would ordinarily consider the significance of the departures from professional standards, as described above, that were disclosed by the review and the pervasiveness of such departures. In that connection, the reviewer needs to give appropriate weight to the fact that the report on an off-site review only addresses conformity with professional standards and not the system of quality control.

Other Departures That May Require Disclosure

4. 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 letter of comments (see appendix J [paragraph .88]).

Appendix H

Standard Form for an Unqualified Report on an Off-Site Peer Review

Firm in the AICPA Peer Review Program*

[State CPA society letterhead for a "CART Review"; firm letterhead for a "Firm-on-Firm Review"; association letterhead for an "Association Review"]

August 31, 19XX

To the Owners
Able, Baker & Co.

or

To John B. Able, CPA

We (I) have performed an off-site peer 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 Peer Review Board of the American Institute of Certified Public Accountants. *[Name of Firm]* has represented to us (me) that it *performed no audits [(or compilations) (or reviews)]*[†] of historical or prospective financial statements during the year ended June 30, 19XX.

An off-site peer 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 peer 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 (I) express no opinion or any form of assurance on them.

In connection with our (my) off-site peer review, nothing came to our (my) attention that caused us (me) to believe that the *[(compilation and review) (compilation) (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]

* No copy of this report or any other documents related to this review will be placed in a public file.

† Tailor as appropriate.

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

Firm in the Private Companies Practice Section*

[State CPA society letterhead for a "CART Review"; firm letterhead for a "Firm-on-Firm Review"; association letterhead for an "Association Review"]

August 31, 19XX

To the Owners
Able, Baker & Co.

or

To John B. Able, CPA

We (I) have performed an off-site peer 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 Peer Review Board of the American Institute of Certified Public Accountants. *[Name of Firm]* has represented to us (me) that it performed no audits *[(or compilations) (or reviews)]*[†] of historical or prospective financial statements during the year ended June 30, 19XX.

An off-site peer 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 peer 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 (I) express no opinion or any form of assurance on them.

In connection with our (my) off-site peer review, nothing came to our (my) attention that caused us (me) to believe that the *[(compilation and review) (compilation) (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.

[Name of Firm] is a member of the private companies practice section of the AICPA Division for CPA Firms (the section) and has agreed to comply with the membership requirements of the section. In connection with our review, we tested the firm's compliance with those requirements to the extent we considered appropriate. Nothing came to our (my) attention that caused us (me) to believe that the firm did not conform with the membership requirements of the section during the year ended June 30, 19XX, in all material respects.

John Brown, Reviewer^{††}

[or Name of Reviewing Firm]

* Pursuant to the membership requirements of the private companies practice section, a copy of this report, the letter of comments, if any, and the firm's response thereto will be placed in the public files of the AICPA Division for CPA Firms, along with the letter from the state CPA society accepting those documents.

[†] Tailor as appropriate.

^{††} The description *Reviewer*, not *Team Captain*, should be used in reports on off-site peer reviews.

Appendix I

Illustrations of Other Types of Reports on an Off-Site Peer Review

[See appendix H [paragraph .86] for information about applicable letterhead and about addressing and signing the report]

Qualified Report for Significant Departures from Professional Standards

[Separate paragraph, after the standard first two paragraphs, describing the significant matters that resulted in a qualified report]

As discussed in our (my) letter of comments under this date, 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, significant financial statement disclosure deficiencies concerning related-party transactions were noted in several of the engagements reviewed.

[Concluding paragraph]

In connection with our (my) off-site peer review, with the exception of the matter(s) described in the preceding paragraph, nothing came to our (my) attention that caused us (me) 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.

Adverse Report on an Off-Site Peer Review

[Separate paragraph, after the standard first two paragraphs, describing the significant matters that resulted in an adverse report]

However, as discussed in our (my) letter of comments under this date, our (my) 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 revenue 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.

[Adverse concluding paragraph]

Because of the significance of the matters described in the preceding paragraph, we (I) believe *[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.

Qualified Report for Noncompliance With the Private Companies Practice Section Membership Requirements*

[Fourth paragraph, after the standard first three paragraphs, describing the noncompliance with the applicable membership requirement]

[Name of Firm] is a member of the private companies practice section of the AICPA Division for CPA Firms (the section) and has agreed to comply with the membership requirements of the section. In connection with our review, we tested the firm's compliance with those requirements to the extent we considered appropriate. Except for the failure of a significant number of professionals to participate in the required number of hours of qualifying continuing professional education, nothing came to our (my) attention that caused us (me) to believe that the firm did not conform with the membership requirements of the section during the year ended June 30, 19XX, in all material respects.

* If the report on accounting practice is adverse, the report on the firm's compliance with the membership requirements of the private companies practice section should also be adverse. This can be accomplished by stating in the last sentence of the fifth paragraph that "We (I) also believe the firm was not in conformity with the membership requirements of the section in all material respects because it did not comply with the AICPA quality control standards for the year ended June 30, 19XX."

Appendix J

Guidelines for and Illustration of a Letter of Comments on an Off-Site Peer Review

Guidelines

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

2. The letter should be addressed, dated, and signed in the same manner as the report on the off-site peer 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 off-site peer review.
- c. A statement that the review was performed in accordance with standards established by the Peer Review Board of the AICPA.
- d. The findings on the review and related recommendations. (Those findings, if any, that resulted in a qualified or adverse report and those that did not should be separated in this section. 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 peer review.)
- e. A statement that the matters discussed in the letter were considered in preparing the report.

3. In addition to matters that resulted in a qualified or adverse report, which must always be included in the letter, the letter of comments should include—

- a. 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.
- b. Instances in which the firm failed to comply with one or more of the membership requirements of the private companies practice section in all material respects, but the instances are not deemed to be significant enough to qualify the report.

Illustration of a Letter of Comments

[State CPA society letterhead for a "CART Review"; firm letterhead for a "Firm-on-Firm Review"; association letterhead for an "Association Review"]

August 31, 19XX

To the Owners
Able, Baker & Co.

or

To John B. Baker, CPA

We have performed an off-site peer 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 Peer Review Board of the American Institute of Certified Public Accountants, and have issued our report thereon dated August 31, 19XX (which was qualified/adverse* as described therein). This letter should be read in conjunction with that report.

An off-site peer review consists only of reading selected financial statements and the accountant's compilation or review report thereon 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 peer 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. However, the following matters did come to our attention during our review.

[Following would be a description of—

- *Matters that resulted in a qualified or adverse report.*
- *Matters that did not result in a qualified or adverse report.]*

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

William Brown, Reviewer

or

Jackson & Allen, P.A. *[For review by a firm]*

* To be included if the reviewer issues a qualified or adverse report. The wording should be tailored to fit the circumstances.

Examples of Matters That Might Be Included in Letters of Comments on Off-Site Peer Reviews

*Matters That Resulted in a Qualified or Adverse Report**

1. *Finding*—During our review, we noted that the firm did not qualify its reports on financial statements when neither the financial statements nor the footnotes noted that the statements were presented on a comprehensive basis of accounting other than generally accepted accounting principles.

Recommendation—We recommend that the firm review the reports issued during the last year and identify those reports which should have been modified to reflect a comprehensive basis of accounting other than generally accepted accounting principles. A memorandum should then be prepared highlighting the changes to be made in the current year and placed in the files of the client for whom a report must be changed.

2. *Finding*—In the engagements that we reviewed, disclosures of related-party transactions and lease obligations as required by generally accepted accounting principles were not included in the financial statements, and the omission was not disclosed in the accountant's reports.

Recommendation—We recommend that the firm review the professional standards governing disclosures of related-party transactions and lease obligations and disseminate information regarding the disclosure requirements to all staff involved in reviewing or compiling financial statements. In addition, we recommend that the firm establish appropriate policies to ensure that all necessary related-party transactions and lease obligations are disclosed in financial statements reported on by the firm. For example, a step might be added to compilation and review work programs requiring that special attention be given to these areas.

3. *Finding*—During our review of the accountants' reports issued by the firm, we noted numerous instances in which the accompanying financial statements departed from professional standards and on which the accountants' reports were not appropriately qualified. These included the following:

- Failure to disclose material intercompany transactions
- Failure to appropriately recognize revenue
- Failure to present financial statements in a proper format
- Failure to recognize conflicting or incorrect information within the financial statements presented

In one instance, the firm has discussed the departures with its client and decided to recall its report and restate the accompanying financial statements.

Recommendation—We recommend that the firm establish a means of ensuring its compliance with professional standards on accounting engagements. Such means might include continuing professional education in accounting and reporting, use of a reporting and disclosure checklist on accounting engagements, or a "cold" review of reports and financial statements prior to issuance.

* This caption is to be used only if a qualified or adverse report is being issued, and it should be tailored to fit the circumstances.

4. *Finding*—On substantially all the engagements that we reviewed, we noted that the firm did not comply with the AICPA Statement on Standards for Accounting and Review Services for reporting on comparative financial statements and going concern issues.

Recommendation—We recommend that the firm review the requirements for reporting on comparative financial statements and revise the standard reports used by the firm to conform with these requirements. Also, the firm should review the requirements governing reporting on going concern issues and provide guidance to the staff in this area.

Matters That Did Not Result in a Qualified or Adverse Report*

5. *Finding*—During our review of computer-generated compiled financial statements prepared by the firm, we noted that the firm failed to indicate the level of responsibility it was taking for supplemental data presented with the basic financial statements.

Recommendation—The firm should revise the standard reports used by the firm to conform with professional standards governing reporting on supplemental data presented with basic financial statements.

6. *Finding*—We noted that computer-generated compiled financial statements prepared on a basis of accounting other than generally accepted accounting principles (GAAP) were properly reported on, but they used titles normally associated with a GAAP presentation.

Recommendation—The firm should review the professional standards governing the titles to be used when financial statements are prepared on a comprehensive basis of accounting other than GAAP and make sure that the software used by the firm is adjusted to conform with these standards. Until the software is revised, the firm should manually prepare the compiled financial statements in accordance with professional standards.

* This caption is to be used only if a qualified or adverse report is being issued, and it should be tailored to fit the circumstances.

Appendix K

Illustration of a Response by a Reviewed Firm to a Letter of Comments on an Off-Site Peer Review

The purpose of a letter of response is to describe the actions 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 .69 through .76]). If the firm has received a qualified or adverse report, the firm's responses should be separated between those findings that resulted in a qualified or adverse report and those that did not.

* * * *

Sample Letter of Response

September 15, 19XX

[Addressed to the state CPA society administering the review]

Ladies and Gentlemen:

This letter represents our (my) response to the letter of comments on the off-site peer review of our firm's (my) accounting practice for the year ended June 30, 19XX.

To prevent the recurrence of the disclosure deficiencies noted by the reviewer and to prevent other disclosure deficiencies from occurring, we (I) have obtained copies of the AICPA reporting and disclosure checklists. These checklists will be completed on all review engagements and on all compilation engagements.

We (I) have established procedures to ensure that our (my) reports and the computer-generated compiled financial statements prepared on a basis of accounting other than generally accepted accounting principles reflect the appropriate titles.

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

Sincerely,

[Name of Firm]

[The next page is 17,901.]

PR Section 9000

INTERPRETATIONS OF STANDARDS FOR PERFORMING AND REPORTING ON PEER REVIEWS

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[The next page is 17,911.]

PR Section 9100

Standards for Performing and Reporting on Peer Reviews (Effective for Peer Review Years Beginning on or After January 1, 1997): Peer Review Interpretations of Section 100

Interpretations of the AICPA Standards for Performing and Reporting on Peer Reviews are developed in open meetings by the AICPA Peer Review Board for peer reviews of firms enrolled in the AICPA peer review program and of members of the Private Companies Practice Section. Interpretations of the Standards need not be exposed for comment and are not the subject of public hearings. These Interpretations are applicable to firms enrolled in the peer review program, members of the Private Companies Practice Section, individuals and firms who perform and report on peer reviews, state CPA societies that participate in the administration of the program, associations of CPA firms that assist their members in arranging and carrying out peer reviews, and the AICPA peer review program staff.

1. On-Site Peer Reviews of Sole Practitioners With Four or Fewer Professionals at a Location Other Than the Practitioner's Office

(Effective for Peer Review Years Beginning on or After January 1, 1997)

.01 Question—Can the on-site peer review of a sole practitioner with four or fewer professional staff be conducted at a location other than the reviewed firm's office?

.02 Interpretation—A review conducted at the reviewer's office or another agreed-upon location can achieve the objectives of an on-site peer 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; (3) the sole practitioner did not receive a qualified or adverse report on his or her last committee-accepted on-site or off-site peer review; and (4) in addition to materials outlined in the "Instructions to Firms Having an On-Site Peer Review" (see PRP 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 (1) identified during the year under review with respect to any

audit or accounting client or (2) 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 quality control policies and procedures questionnaire (see PRP sections 4200.03.B.4 and 4300.03.C.7)
- f. A list of audit and accounting materials, if any, identified in response to the questions in the "Engagement Performance" section of the quality control policies and procedures questionnaire (see PRP section 4200.03.C)
- g. Continuing Professional Education (CPE) records sufficient to demonstrate compliance by the CPAs in the firm with state and AICPA CPE requirements
- h. The relevant working paper files and reports on the engagements selected for review
- i. Any other evidential matter requested by the reviewer
- j. Documentation of compliance with the membership requirements of the Private Companies Practice Section (if applicable)

.03 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.

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

[Issue Date: January, 1997.]

2. Engagement Selection in On-Site Peer Reviews

(Effective for Peer Review Years Beginning on or After January 1, 1997)

.05 *Question*—Paragraph 48 of the *Standards for Performing and Reporting on Peer Reviews* (Effective for Peer Review Years Beginning on or After January 1, 1997) [section 100.48], states: "The AICPA Peer Review Board may from time to time, by Interpretations, require that specific types of engagements be selected for review—for example, engagements required by a regulatory agency to be reviewed or those in particular areas in which public interest exists." On an on-site peer review, what specific type of engagements, if any, should be included in the sample of engagements selected for review or assessed at a higher level of peer review risk?

.06 Interpretation—At least one of each of the following types of engagements should be selected for review on an on-site peer review:

- a. **Governmental**—*Government Auditing Standards* (the Yellow Book), issued by the U.S. General Accounting Office, require auditors conducting audits in accordance with those standards to have a peer review that includes the review of at least one audit conducted in accordance with those standards. If a firm performs an audit of an entity subject to *Government Auditing Standards* and the peer review is intended to meet the requirements of those standards, at least one engagement conducted pursuant to those standards should be selected for review.
- b. **Depository Institutions**—The 1993 Federal Deposit Insurance Corporation (FDIC) guidelines implementing the FDIC Improvement Act of 1991 (the Act) require auditors of federally insured depository institutions with more than \$500 million in total assets to have a peer review that includes the review of at least one audit of an insured depository institution subject to the Act. If a firm performs an audit of a federally insured depository institution subject to the Act and the peer review is intended to meet the requirements of the Act, at least one engagement conducted pursuant to the Act should be selected for review. The review of that engagement should include a review of the reports on internal control or compliance with laws and regulations, since those reports are required to be issued under the Act.

.07 During the assessment of peer review risk on an on-site peer review, the following types of engagements should be assessed at a higher level of peer review risk:

- a. **Employee Benefit Plans**—Regulatory and legislative developments have made it clear that there is a significant public interest in and a higher risk associated with audits conducted pursuant to the Employee Retirement Income Security Act of 1974 (ERISA). Therefore, audits of entities subject to ERISA should be assessed at a higher level of peer review risk. If a firm performs the audit of one or more entities subject to ERISA and at least one such audit engagement is not selected for review, the review team should document its justification for why not in question II.D.3 of the Summary Review Memorandum.
- b. **Securities and Exchange Commission (SEC)**—Firms that audit one or more SEC clients as defined by Council in an Implementing Resolution under Bylaw Section 2.3.5 [BL section 230R.08] are required to enroll in the SEC Practice Section unless they have resigned, declined to stand for reelection, or been dismissed as auditor of all such clients. Only then can they enroll in the AICPA peer review program. Therefore, because there is a significant public interest in and a higher risk associated with audits of SEC registrants, such engagements should be assessed at a higher level of peer review risk. If a firm performs the audit of one or more SEC registrants during the year under review and at least one such audit engagement is not selected for review, the review team should document its justification for why not in question II.D.3 of the Summary Review Memorandum. 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 reelection, 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 during the year under review if the reviewed firm has not previously had a review.

[Issue Date: January, 1997.]

3. Team Captain Training Course

(Effective for Peer Review Years Beginning on or After January 1, 1997)

.08 Question—Paragraph 23 of the *Standards for Performing and Reporting on Peer Reviews* (Effective for Peer Review Years Beginning on or After January 1, 1997) [section 100.23] states that a team captain on an on-site peer review should "have completed a training course or courses that meet requirements established by the AICPA Peer Review Board" in order to qualify for service as a team captain. Paragraph 24 of the *Standards for Performing and Reporting on Peer Reviews* (Effective for Peer Review Years Beginning on or After January 1, 1997) [section 100.24] states that a reviewer on an off-site peer review should "have completed a training course or courses that meet requirements established by the AICPA Peer Review Board" in order to qualify for service as a reviewer. What specific type of course or courses, if any, should an on-site team captain and off-site reviewer complete?

.09 Interpretation—A team captain on an on-site peer review and a reviewer on an off-site peer review should have completed an AICPA Peer Review Board-approved training course during the five-year period prior to the commencement of the review. Only AICPA-developed training courses are discussed below. The AICPA Peer Review Board may from time to time approve other reviewer training courses.

.10 To initially qualify as an on-site team captain, an individual should complete the AICPA two-day introductory reviewer training course, "How to Conduct a Review Under the AICPA Practice-Monitoring Program" ("How to"). Thereafter, during the five-year period prior to the commencement of a review, an on-site team captain should complete the AICPA two-day introductory "How to" training course; the AICPA one-day advanced reviewer training course, "Advanced Training Course for Reviewers: Current Issues in Practice Monitoring" (previously titled "Current Issues in Practice Monitoring: An Advanced Guide for Reviewers"); or the AICPA annual one-and-a-half-day "Peer Review Program Conference." The above-mentioned "How to" training course also fulfills the initial education requirements for service as an off-site reviewer. All of the above-mentioned courses fulfill the continuing education requirements for services as an off-site reviewer.

.11 To qualify initially as an off-site reviewer, an individual should complete either the first day of the AICPA two-day introductory "How to" training course or the one-day off-site introductory reviewer training course, "How to Perform and Report on Off-Site Peer Reviews." These courses also fulfill the continuing education requirements for off-site reviewers. They do not, however, fulfill the initial or continuing education requirements for service as an on-site team captain.

[Issue Date: January, 1997.]

[The next page is 17,921.]

PR Section 9100A

Standards for Performing and Reporting on Peer Reviews (Effective for Peer Review Years Beginning Before January 1, 1997): Peer Review Interpretations of Section 100A

Interpretations of the Standards for Performing and Reporting on Peer Reviews are developed in open meetings by the AICPA Peer Review Board for peer reviews of firms enrolled in the AICPA peer review program and of members of the private companies practice section. 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 peer review program, members of the private companies practice section, individuals and firms who perform and report on peer reviews, state CPA societies that participate in the administration of the program, associations of CPA firms that assist their members in arranging and carrying out peer reviews, and the AICPA Peer Review Division itself.

In the fall of 1994, the AICPA Board of Directors and the AICPA Council approved the combination of the peer review program of the private companies practice section and the AICPA quality review program. At that time, the AICPA quality review program was renamed the AICPA peer review program and the executive committee having senior status with authority to establish and conduct the review program in cooperation with state CPA societies was renamed the AICPA Peer Review Board. The Standards for Performing and Reporting on Peer Reviews were formerly called the Standards for Performing and Reporting on Quality Reviews.

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

.01 *Standards for Performing and Reporting on Peer Reviews (Standards [section 100A]) require firms that perform audits of historical or prospective financial statements to have on-site peer reviews [section 100A.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 peer reviews" was used in the *Standards* [section 100A]. 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 peer 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 finding, and the reviewer's conclusions on the review; (3) provided the sole practitioner did not receive a qualified or adverse report on the firm's last committee accepted on-site or off-site peer or quality review (effective for reviews performed on or after April 1, 1996); and (4) in addition to materials outlined in the "Instructions to Firms Having an On-Site Peer Review" (see PRP section 4100A.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 questions B.4 and C.7 of the questionnaire (see PRP sections 4200.03.B.4 and 4300.03.C.7).
- f. A list of audit and accounting materials, if any, identified in response to the questions in the "Supervision" section of the questionnaire (see PRP sections 4200.03.C and 4300.03.D).
- g. Continuing professional education (CPE) records sufficient to demonstrate compliance by the CPAs in the firm with state and AICPA CPE requirements.
- h. The relevant working paper files and reports on the engagements selected for review.
- i. Any other evidential matter requested by the reviewer.
- j. Documentation of compliance with the membership requirements of the private companies practice section (if applicable).

.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 peer review.

[Issue Date: January, 1990; Amended: May, 1992; Amended: October, 1994; Amended: May, 1995.]

2. Selection in On-Site Peer Reviews of ERISA and Depository Institution Audit Engagements

.06 *Question*—During the 1990s, regulators and legislators focused attention on the quality of audits conducted by CPA firms. If a firm performs an audit pursuant to the Employee Retirement Income Security Act of 1974 (ERISA) or an audit of a depository institution subject to the Federal Deposit Insurance Corporation Improvement Act of 1991 (the Act), should such engagements be selected for review in an on-site peer review?

.07 *Interpretation*—The *Standards for Performing and Reporting on Peer Reviews* (*Standards* [section 100A]) require that the engagements selected for review in an on-site peer 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* [section 100A] require that the sample of engagements include at least one audit conducted pursuant to *Government Auditing Standards* issued by the U.S. General Accounting Office [section 100A.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 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 ERISA. Accordingly, greater weight should be given in the engagement selection process on on-site reviews to those audits if the firm performs such engagements.

.10 The 1993 Federal Deposit Insurance Corporation (FDIC) guidelines implementing the FDIC Improvement Act of 1991 require auditors of federally insured depository institutions with more than \$500 million in total assets to have a peer review that includes the review of at least one audit of an insured depository institution subject to the Act. If a firm performs an audit of a federally insured depository institution subject to the Act and the peer review is intended to meet the requirements of the Act, at least one engagement conducted pursuant to the Act should be selected for review. The review of that engagement should include a review of the reports on internal control or compliance with laws and regulations since those reports are required to be issued under the Act.

[Issue Date: December, 1990; Amended: October, 1993;
Amended: October, 1994.]

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

.11 *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 or the firm was assigned a due date beyond the three-year period for its subsequent review, is the reviewer permitted to serve as a team captain on an on-site peer review or as a reviewer on an off-site peer review?

.12 *Interpretation*—The *Standards for Performing and Reporting on Peer Reviews* [section 100A.18 and .21] require 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.

.13 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 reviewer'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 on an on-site peer review or as a reviewer on an off-site peer review are met and (2) the firm's most recent review resulted in an unqualified report or a report not adverse or qualified for significant departures from professional standards on an off-site peer review.

.14 Similarly, if a firm is assigned a due date beyond the three-year period for its subsequent review, the requirement that a reviewer's firm must have a review within the previous three years will be waived for a period of time up to the due date assigned for the subsequent review provided that (1) the due date assigned is not beyond three years and six months after the end of the period covered by the previous peer or quality review and (2) the firm's most recent review resulted in an unqualified report or a report not adverse or qualified for significant departures from professional standards on an off-site peer review.

[Issue Date: June, 1991; Amended: January, 1994; Amended: October, 1994.]

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

[.15-.18] [Deleted January 1994]

[5.] Off-Site Reviewer Qualifications: Effect of a Firm's Review Status

[.19-.23] [Deleted January 1994]

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

[.24-.25] [Deleted January 1994]

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

.26 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 230R.08] may enroll in the peer review program or the Private Companies Practice Section 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 peer review?

.27 Interpretation—The *Standards for Performing and Reporting on Peer Reviews* [section 100A] 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 firm.

.28 In addition, the reviewer should satisfy himself or herself that the SEC has been notified by appropriate filings of Forms 8-K 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 during the year under review if the reviewed firm has not previously had a review.

[Issue Date: May, 1992; Amended: October, 1994.]

8. Reviewer Experience Requirements

.29 Question—The *Standards for Performing and Reporting on Peer Reviews* (*Standards*), paragraph 17 [section 100A.17], states that "an individual serving as a reviewer (whether for on-site or off-site peer reviews) must be a member of the AICPA licensed to practice as a certified public accountant, must possess current knowledge of applicable professional standards, and must be currently active in public practice at the supervisory level in the accounting or auditing function of a firm enrolled in an approved practice-monitoring program." What do the *Standards* [section 100A] mean by "possess current knowledge of professional standards" and "currently active in . . . auditing function?"

.30 Interpretation—Footnote 5 to paragraph 18 of the *Standards* [section 100A.18] states that the standard set forth in paragraph 18 [section 100A.18] "is not intended to require that reviewers spend all their time on accounting and auditing engagements" and that reviewers "should carefully consider whether their day-to-day involvement in accounting and auditing work is sufficiently comprehensive to enable them to perform a peer review with professional expertise."

.31 A reviewer would be considered "currently active in . . . auditing function" if he or she is currently involved in the auditing practice of his or her firm either supervising one or more of the firm's audit engagement teams or carrying out a quality control/review function on the firm's audit engagements.

.32 For a reviewer to be considered to have “current knowledge of applicable professional standards,” he or she should also be knowledgeable about current rules and regulations applicable to the industries he or she reviews. Such knowledge may be obtained from training courses, on-the-job training, or a combination of both.

.33 Because some industries are high-risk and complex, they require a higher level of knowledge and recent practice experience. Therefore, if a reviewer does not have recent practice experience in such an industry, the reviewer may be called upon to justify why he or she should be permitted to review engagements in that industry.

.34 The entity administering the review has the authority to decide whether a reviewer’s experience is sufficient to perform a particular review.

[Issue Date: September, 1992; Amended: October, 1994.]

9. Reviewer Qualifications: Association With a Firm That Has Had a Review

.35 *Question*—Paragraph 17 of the *Standards for Performing and Reporting on Peer Reviews* (*Standards* [section 100A.17]) states that an individual serving as a reviewer (whether for on-site or off-site peer 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) an owner of the firm” or “(b) a manager or person with equivalent supervisory responsibilities.” Paragraph 18 of the *Standards* [section 100A.18] further states that “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.” Similarly, paragraph 21 of the *Standards* [section 100A.21] states that “off-site reviewers must also be associated with a firm that has received, within the three previous years, either of the following:

- a. An unqualified report on its system of quality control.
- b. A report on an off-site review that is not adverse or qualified for significant departures from professional standards.”

If a reviewer is associated with more than one firm as an owner, manager, or person with equivalent supervisory responsibilities, must each of the firms with which the reviewer is associated comply with these requirements?

.36 *Interpretation*—If a team captain on an on-site peer review or an individual conducting an off-site peer review is associated with more than one firm, all of those firms subject to an on-site review or an off-site review must not have received an adverse report, or a report qualified for its system of quality control or qualified for significant departures from professional standards.

[Issue Date: February, 1995; Amended: May, 1995.]

10. Reviewer Qualifications: Association With Newly Formed Firms

.37 *Question*—Paragraph 18 of the *Standards for Performing and Reporting on Peer Reviews* (the *Standards* [section 100A.18]), states that “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.” Paragraph 21 of the *Standards* [section 100A.21] states that “off-site reviewers must also be associated with a firm that has received, within the three previous years, either of the following:

- a. An unqualified report on its system of quality control
- b. A report on an off-site review that is not adverse or qualified for significant departures from professional standards.”

If an individual starts or joins a newly formed firm, which has never been peer reviewed, can the individual continue to conduct on-site and off-site peer reviews until his or her new firm is peer reviewed?

.38 Interpretation—An individual who was previously associated with a firm that received an unqualified report on its system of quality control that starts or joins a newly formed firm will be deemed to be in compliance with the paragraph 18 [section 100A.18] requirement described above and may serve as a team captain on on-site peer reviews during the twelve-month transitional period beginning with the date the individual disassociates from his or her previous firm, provided the individual possesses all of the other qualifications for service as an on-site peer review team captain. Similarly, an individual conducting off-site peer reviews is deemed to be in compliance with the paragraph 21 [section 100A.21] requirement set forth above during the twelve-month transitional period beginning with the date the individual disassociates from his or her previous firm, provided the individual possesses all of the other qualifications for service as an off-site reviewer.

[Issue Date: October, 1995.]

[The next page is 18,001.]