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## Guide to implement the voluntary quality control review program for CPA firms; Performing and reporting on quality control compliance reviews; Discussion draft (American Institute of Certified Public Accountants), 1977, October 28

American Institute of Certified Public Accountants. Special Committee on Proposed Standards for Quality Control Policies and Procedures

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# **DISCUSSION DRAFT**

## **A GUIDE TO IMPLEMENT THE VOLUNTARY QUALITY CONTROL REVIEW PROGRAM FOR CPA FIRMS**

### **PERFORMING AND REPORTING ON QUALITY CONTROL COMPLIANCE REVIEWS**

**OCTOBER 28, 1977**

**Issued by the Special Committee on Proposed Standards for  
Quality Control Policies and Procedures**

**AICPA, 1211 Avenue of the Americas, New York, N.Y. 10036**



October 28, 1977

To Practice Offices of CPA Firms;  
Members of Council; Technical Committee  
Chairmen; State Committee Chairmen; & Persons  
Who Have Requested Copies:

A discussion draft of a proposed guide to implement the Voluntary Quality Control Review Program for CPA Firms, entitled Performing and Reporting on Quality Control Compliance Reviews, accompanies this letter.

The proposed guide was developed by the Special Committee on Proposed Standards for Quality Control Policies and Procedures in order to provide guidance for performing and reporting on quality control compliance reviews under the Voluntary Review Program which was approved by Council in October 1976.

The proposed guide is the second to be issued by the special committee in implementing the Voluntary Review Program. The first, entitled Quality Control Policies and Procedures for Participating CPA Firms, provides guidance in the establishment of quality control policies and procedures by a CPA firm intending to participate in the Voluntary Review Program and has recently been published in final form.

A CPA firm intending to participate in the Voluntary Review Program should consider the objectives of the compliance review as stated in the proposed guide and the nature and extent of procedures that would be performed by a review team conducting a compliance review. The proposed guide also provides guidance on reporting considerations and contains a model form of report acceptable for participation in the Voluntary Review Program.

The discussion draft was developed in connection with the implementation of the Voluntary Review Program; however, it is expected that the proposed guide will also be significant input in the development of standards for peer reviews conducted under the authority of the Peer Review Committees of the AICPA division of firms established by resolution of Council on September 17, 1977.

The special committee recognizes that practices relating to quality control matters are evolving, and accordingly believes that the guide should be reviewed from time to time to determine whether the material requires modification, update, or amendment in the light of future developments in practice.

Comments and suggestions on any aspect of this discussion draft are sought and will be appreciated. They should be addressed to the Special Committee on Proposed Standards for Quality Control Policies and Procedures at the AICPA in time to be received by December 15, 1977. The special committee will be interested particularly in the reasoning underlying comments and suggestions. Sincerely,



Robert W. Burmester, Chairman  
Special Committee on Proposed  
Standards for Quality Control  
Policies and Procedures



William C. Bruschi  
Vice President, Review & Regulation

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## INTRODUCTION

The purpose of this guide is to provide guidance for performing and reporting on quality control compliance reviews in connection with the AICPA Voluntary Quality Control Review Program for CPA Firms (the "program").<sup>1</sup> It should be read in conjunction with other guidance material issued to implement the program.

In order to participate in the program, a CPA firm must undergo a quality control compliance review performed in accordance with the guidelines set forth herein and file an acceptable report (as discussed elsewhere herein) thereon with the AICPA. To continue as a participant, a CPA firm must undergo a compliance review at least once every three years and file an acceptable report thereon with the AICPA.

The purpose of a firm's considering the elements of quality control and adopting quality control policies and procedures for its accounting and auditing practice is to provide reasonable assurance that it is conforming with generally accepted auditing standards. For participat-

<sup>1</sup> The terms *compliance reviews* and *field reviews*, as they are used in the program, are synonymous and are used interchangeably in this document.

ing firms an additional purpose is to provide documentation or other evidential matter that will facilitate a subsequent compliance review.<sup>2</sup>

The quality control policies and procedures adopted by a participating firm will depend in part upon the firm's organizational structure, including factors such as its size, the degree of operating autonomy appropriately allowed to its personnel and its practice offices, the nature of its practice, and its administrative controls.

A participating firm is required to make available to the review team the documented quality control policies and procedures incorporated in its quality control system.<sup>3</sup> This requirement is met by furnishing one of the following to the review team:

<sup>2</sup> As used in this document, the term *participating firm* encompasses those firms that are preparing for involvement in the program as well as participants. A firm is identified as a participant in the program only upon completion of its compliance review and filing with the Institute an acceptable report on that review.

<sup>3</sup> The system of quality control maintained by a CPA firm encompasses the firm's organizational structure and the policies adopted and procedures established to provide reasonable assurance

1. A quality control document that provides a detailed description of a firm's quality control policies and procedures.
2. A summary statement of a firm's quality control policies and procedures with references to supporting information contained in manuals, memorandums, or other technical literature of the firm.

A quality control document or summary, in addition to discussing the firm's quality control policies and procedures, may also contain a description of the firm's organization (including an organization chart), a discussion of its philosophy of practice, and other descriptive material relating to the elements of quality control and the firm's operations.

The guidance included herein is applicable to reviewing entities ("review teams") and to individual reviewers ("review team members") who perform or are involved in quality control compliance reviews and who report on such reviews under the program.

of conforming with professional standards in the conduct of the firm's accounting and auditing practice.

## PERFORMING QUALITY CONTROL COMPLIANCE REVIEWS

### OBJECTIVES OF THE COMPLIANCE REVIEW

Compliance reviews are designed to evaluate whether a reviewed firm's system of quality control for its accounting and auditing practice is appropriately comprehensive and suitably designed for the reviewed firm and whether its quality control policies and procedures are adequately documented, communicated to professional personnel, and are generally being complied with

to provide reasonable assurance that the firm conforms with the guidelines of the profession for firms participating in the program.<sup>4</sup>

It is intended that this evaluation be accomplished by—

<sup>4</sup> As used in this context, *documentation* refers both to the reviewed firm's documented quality control policies and procedures as well as to supporting materials presented to the review team as evidence of compliance with those policies and procedures.

- Study and evaluation of a reviewed firm's quality control system.
- Review for compliance with a reviewed firm's quality control policies and procedures by—  
Review at each organiza-

As used in this document, *compliance* means adherence to a prescribed policy or procedure in the substantial majority of situations; it does not imply adherence to a prescribed policy or procedure in every case.



tional or functional level within the firm.

Review of selected engagement working paper files and reports.

Upon completion of a compliance review, the review team communicates its findings to the reviewed firm and prepares a written report in accordance with the guidelines for reporting on quality control compliance reviews.

### CONFIDENTIALITY

The compliance review is to be conducted with due regard for requirements of confidentiality of the rules of conduct of the code of professional ethics of the AICPA. Information obtained as a consequence of the review with regard to the reviewed firm or any of its clients is confidential and should not be disclosed by the review team members to anyone not associated with the review.

It is the responsibility of the reviewed firm to take such measures, if any, as may be necessary to satisfy its obligations with regard to client confidentiality. Rule 301 of the AICPA's code of professional ethics contains an exception to the confidentiality requirements so that review of a member's professional practices as part of a voluntary quality review under AICPA authorization is not prohibited. Some state statutes or ethics rules promulgated by state boards of accountancy may, however, not clearly provide a similar exception regarding client confidentiality.<sup>5</sup> Accordingly, a reviewed firm may wish to consult its legal counsel to determine whether any action is required to permit client engagement files to be made available to the review team.

### ORGANIZATION OF THE REVIEW TEAM

A review team may be (1) appointed by the quality control review committee, (2) formed by a CPA firm engaged by the firm un-

der review, or (3) appointed by another entity which, with the approval of the quality control review committee, administers the program for the committee, such as a state society of CPAs.

A review team is headed by a team captain who directs the organization and conduct of the review, supervises other reviewers, and is responsible for preparation of a report on the review. The review team captain is to be a partner currently involved in the audit function.<sup>6</sup> In some larger review engagements, it may be useful for the team captain to designate other partners to serve with the team captain as an executive or supervisory committee for the review and to participate in evaluating the findings of the review team. In the case of a multioffice firm, the reviewers visiting a selected practice office are under the direction of a partner (subject to the overall direction of the team captain) who supervises the conduct of the review and the work performed at that location.

### QUALIFICATIONS FOR INDIVIDUALS TO SERVE AS REVIEWERS

The nature and complexity of a compliance review requires the exercise of professional judgment. Accordingly, individuals serving as reviewers shall be CPAs, shall be independent of the reviewed firm, and shall possess current knowledge of accounting and auditing matters. A reviewer shall be currently active at a supervisory level in the accounting and auditing function with a CPA firm, that is, as a partner or manager with a CPA firm, in an equivalent supervisory position with a professional corporation, or as a sole practitioner.

In situations where required by the nature of the reviewed firm's practice, a consultant to the reviewers may be used. Consultants should be individuals with expertise in a special area but need not be CPAs. For example, computer

specialists, statistical sampling specialists, actuaries, or educators expert in professional development may participate in certain segments of the review. Consultants should also be independent of the reviewed firm.

### QUALIFICATIONS FOR A REVIEWING FIRM

When a CPA firm is requested to perform a review engagement, the criteria discussed below should be considered by the firm in determining its capability to perform the compliance review prior to accepting the engagement. Individuals selected by the CPA firm to participate as review team members in a review engagement should possess the requisite qualifications for reviewers or consultants.

**Participating Firm.** A reviewing firm shall be a participant in the program. Since no firm can be a participating firm at the inception of the program or until the expiration of an interim period described in the program, the requirement that a reviewing firm be a participant in the program is not applicable prior to or during the interim period. During the interim period, however, a reviewing firm shall have filed a letter of intent to participate in the program before issuing a report under the program.

**Capability.** A reviewing firm must determine its capability to perform a compliance review. Prior to accepting an engagement, the reviewing firm should obtain information about the firm to be reviewed, including certain operating statistics pertaining to size and type of practice.

In determining its capability to perform the engagement, the reviewing firm should consider the size of the firm to be reviewed in relation to its own size. A reviewing firm must recognize that the performance of a compliance review may demand substantial commitments of time, especially from its senior supervisory audit personnel. Therefore, a firm should consider carefully the number and availability of supervisory personnel in determining its capability to perform a compliance review of another firm.

<sup>5</sup> The AICPA maintains a current listing of states that do not clearly provide an exception to the confidentiality requirements discussed in this section. Such information may be obtained upon request.

<sup>6</sup> As used in this document, *partner* refers to an individual who is at the partner level in a CPA firm, a sole practitioner, or in an equivalent position with a professional corporation.

The reviewing firm must have available to it reviewers with appropriate levels of expertise and experience to perform the review. If the reviewed firm has a specialized practice, such as a concentration in particular industries or in governmental audits, the reviewing firm must determine its capability to deal therewith. In the case of reviews of firms with SEC practices, the reviewing firm must have available reviewers for SEC engagements who are knowledgeable of current SEC rules and regulations.

In some instances, a reviewing firm may use a correspondent firm to perform a portion of a compliance review engagement. In such cases, the principal reviewing firm must (1) be satisfied as to the capability of the correspondent, (2) assume responsibility for the work performed by the correspondent, (3) adopt appropriate measures to assure the coordination of its activities with the correspondent, and (4) make arrangements to satisfy itself as to the work performed by the correspondent. The report on the review should not make reference to a correspondent firm's participation in the review. In order to determine its capability to perform its portion of a compliance review, a correspondent firm should also consider the requirements discussed herein prior to accepting an engagement.

### GENERAL CONSIDERATIONS

**Independence.** Independence with respect to the reviewed firm must be maintained by reviewing firms, by review team members, and by their consultants. The AICPA's code of professional ethics does not specifically consider relationships between reviewers, reviewed firms, and clients of reviewed firms. However, the concepts pertaining to independence embodied in the code should be considered for their application.

Reciprocal reviews are not permitted. This prohibition is applicable to a reviewing firm and, for a review conducted by a committee-appointed review team, to the firm with which the review team captain is associated.

Reviewing firms should consider any family or other relationships between the firms' senior managements at organizational and functional levels in assessing the possibility of an impairment of independence.

Some firms perform engagement correspondent work for other firms. The correspondent firm's fee may be paid by the referring firm or directly by the client. In either situation, if the fees for the correspondent work are material to either the reviewed firm or reviewing firm, independence for purposes of the program is impaired.

Some reviewers or their firms may have continuing arrangements with other firms whereby fees, office facilities, or staff are shared. In these situations, independence for purposes of the program is impaired.

**Conflict of Interest.** A review team member should not have conflicts of interest with respect to the reviewed firm or to those of its clients that are the subject of engagements reviewed by that member. The personnel of a reviewing firm and the reviewing firm itself are not precluded from owning securities of clients of the reviewed firm. However, since confidential information may be obtained during the course of a review, a review team member shall not own securities of a reviewed firm's client that is the subject of an engagement reviewed by that member. In addition, the effect of family relationships (close kin, remote kin) and other relationships and the possible resulting conflict of interest must be considered when assigning team members to review individual engagements.

**Competence.** Review teams must have knowledge of the type of practice to be reviewed, including expertise in specialized industries in which the reviewed firm practices. In the case of reviews of firms with SEC practices, review teams must have available reviewers for SEC engagements who are knowledgeable of current SEC rules and regulations.

In determining the composition of a review team, consideration

should be given to the areas to be reviewed and the expertise required for various segments of the review.

The work of review teams at each organizational level of the reviewed firm should be supervised by a partner in the audit function.

**Due Care.** Due care is to be exercised by the review team in the performance of the review and in the preparation of the report. Due care for quality control compliance reviews imposes an obligation on each review team member to fulfill assigned responsibilities in a professional manner similar to that of an independent auditor examining financial statements.

### THE FIELD REVIEW

The field review should include the following:

- A study and evaluation of the reviewed firm's quality control system.
- Review for compliance with a reviewed firm's quality control policies and procedures by—
  - Review at each organizational or functional level within the firm.
  - Review of selected engagement working paper files and reports.
- Preparation of a written report on the results of the review.

For a multioffice firm, the review would include visits to the firm's executive office and selected regional and practice offices.

Prior to commencement of the review, the parties to the review may wish to document formally the terms and conditions of the engagement.

**Scope of Review.** The scope of the review should cover those segments of a firm's accounting and auditing practice wherein the firm is associated with financial statements, including unaudited financial statements. Other segments of a firm's practice, such as providing tax services or management advisory services, are not encompassed by the scope of the review except to the extent they are associated with financial statements (for example, reviews of tax provisions and accruals contained in financial

statements are included in the scope of the review).

The review should cover a current period (generally one year) to be mutually agreed upon by the reviewed firm and the review team. It is anticipated that quality control policies and procedures may be revised, updated, or amended during the period under review to recognize changing conditions and new professional standards. The scope of the review should encompass the quality control policies and procedures in effect and compliance therewith for the period under review. Client engagements subject to selection for review would be those with years ending during the period under review unless a more recent report has been issued at the time the review team selects engagements.

The review will be directed to the professional aspects of the reviewed firm's accounting and auditing practice; it will not include business aspects of that practice. It may be difficult, however, to distinguish between these aspects of the practice since they may overlap. For example, in evaluating whether the supervision of an engagement was adequate, review team members would consider budgeted and actual time spent for the engagement by various categories or classifications of personnel but would not normally inquire as to fees billed to the client or the relationship of fees billed to time accumulated at usual or standard billing rates.

Review teams would not normally review compensation of professional personnel but, when reviewing policies and procedures for advancement, would concern themselves with whether professional personnel were promoted based on demonstrated competence and whether criteria for admission of individuals to the firm give appropriate weight to professional qualifications.

Review team members will not have contact with, or access to, any client of the reviewed firm in connection with the review.

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 may be the subject of litigation or investigation by a governmental 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. The review team should satisfy itself as to the reasonableness of the explanation; if the team is not satisfied, the matter should be reported to the reviewed firm's managing partner, and the review team should consider what other action may be appropriate in the circumstances. If the engagements so excluded from the review process are few in number and do not materially affect the review coverage, the review team ordinarily would conclude that the scope of the review had not been unduly restricted.

The field review should deal with the accounting and auditing engagements performed by the United States offices of the reviewed firm and should not cover work performed on engagements outside the United States. The reviews of engagements should usually be directed toward the accounting and auditing work performed by the practice offices visited and not to a review of work performed by all practice offices of the reviewed firm connected with a particular engagement. Accordingly, in reviewing a selected practice office, the accounting and auditing work performed by that practice office includes work performed for another office of the reviewed firm, for a correspondent firm, or for an affiliated firm.

For those situations in which engagements selected in the practice office reviewed include use of the work of another office, correspondent, or affiliate (domestic or international), the review team would normally limit its review to the portion of the engagement performed by the selected practice office. The review, however, should include instructions for the engagement issued by the reviewed office to another office of the firm, correspondent, or affiliate. In addition, the review should also encompass the

procedures by which the reviewed office maintains control over the engagement through supervision (including visits by its supervisory personnel to other locations) and review of work performed by others.

There may be situations when information available to the review team is insufficient for it to evaluate whether the reviewed firm's quality control policies and procedures have been applied in supervising engagements performed by other offices or firms. In these instances, it will be necessary at least to obtain documentation from such other offices or firms; usually this may be accomplished by forwarding the requested information to the reviewed office.

**Planning the Review.** The review team should obtain background information from the reviewed firm, some of which will have been obtained before the engagement was accepted. The information is used as a guide for planning purposes (including selection of offices to be visited and engagements to be reviewed) and should relate to the reviewed firm's accounting and auditing practice. The statistical information may be in terms of approximate amounts or estimates. The following are examples of background information that may be obtained from the reviewed firm:

1. Description of the firm's organization (an organization chart may be useful).
2. Firm philosophy including matters such as—
  - a. Firm goals or objectives.
  - b. Operating practices regarding service to clients and development of personnel.
  - c. Policies relating to industry specialization or practice specialists.
  - d. Operating autonomy of practice offices (the extent of decentralization of authority).
3. Firm profile. (If the reviewed firm is a multioffice firm, the information should be broken out by individual practice office. Offices that are part of a

larger practice unit may be grouped together).

- a. Size — accounting and auditing hours. (If such an analysis is not available, the reviewed firm may analyze total billings by function, or make an estimate of the percentage of accounting and auditing work.)
- b. Number of professional accounting and auditing personnel analyzed by level.
- c. Number of accounting and auditing clients classified by “audited” and “un-audited” and by type—publicly held, privately held, or governmental.
- d. Firm management level personnel analyzed by years with the firm and areas of expertise.
- e. Industry concentrations and specialty practice areas, such as SEC or regulated industries.
- f. Extent of use of correspondent firms on engagements.
- g. Extent of international practice.
- h. Description of recent mergers.

**Study and Evaluation of the Quality Control System.** After the background information is obtained and studied, the review team should commence its study and evaluation of the reviewed firm’s quality control system. The objective of the study is to evaluate whether the quality control policies and procedures are appropriately comprehensive and suitably designed for the reviewed firm, are adequately documented, and the procedures for communicating them to professional personnel are appropriate. This evaluation as to comprehensiveness and suitability should be considered further by the review team in the course of the review and may be modified by the review team based on the results of its other review and compliance testing procedures.

The reviewed firm’s quality control policies and procedures should

be considered in relation to the guidance material contained in the *Guide to Implement the Voluntary Quality Control Review Program for CPA Firms: Quality Control Policies and Procedures for Participating CPA Firms*. This process would assist the review team in evaluating whether the reviewed firm has given adequate consideration to, and adopted, appropriately comprehensive and suitably designed policies and procedures for each of the elements of quality control to the extent they are applicable to its practice.

If significant apparent deficiencies are identified in the reviewed firm’s quality control policies and procedures, the review team should bring them to the attention of the reviewed firm’s managing partner or to another appropriate authority in the firm. The reviewed firm would be given an opportunity to refute or correct such apparent deficiencies. If significant corrective actions are required, the review will usually be suspended for a sufficient period of time for the reviewed firm to develop revised policies or procedures and implement them in its practice. The review team should consider communicating such significant deficiencies to the reviewed firm, generally in writing, at the time the review is suspended. The review team would, in resuming the review, evaluate whether the revised policies or procedures correct the deficiencies.

**Extent of Compliance Tests.** Based on its study and evaluation of the reviewed firm’s quality control policies and procedures, the review team should develop programs to test compliance.<sup>7</sup> The programs for compliance tests should be tailored to the practice of the firm under review and should be sufficient to evaluate whether the reviewed firm’s quality control policies and procedures have been adequately communicated to professional personnel and are being

complied with. The nature and extent of testing should take into account the review team’s evaluation of the relative strengths and weaknesses of the reviewed firm’s quality control policies and procedures. Some of these compliance tests would be performed at practice offices selected for review, some on a firm-wide basis, and others on an individual engagement basis. These tests may take the form of—

- Inquiries of persons responsible for a function or activity.
- Review of selected administrative and personnel files.
- Interviews with firm professional personnel at various levels.
- Review of the results of the firm’s internal inspection function.
- Review of selected engagement working paper files and reports.
- Review of other evidential matter.

**Location of Documentation—**The review team should determine the work to be accomplished at the reviewed firm as to compliance with quality control policies and procedures and the location of related documentation, which may be maintained in functional or administrative files. In the case of a multioffice firm, attention should be directed to a review of documentation maintained at the executive office. For example, the executive office probably has statistics, records, and other data relative to procedures regarding client acceptance and continuance, hiring, training, promotion, and independence and may also have data useful in evaluating compliance with the firm’s quality control policies and procedures for consultation and inspection.

**Selection of Offices—**The process of office selection is not subject to definitive criteria; visits to practice offices should be sufficient to enable the review team to evaluate whether the reviewed firm’s quality control policies and procedures are adequately communicated to professional personnel and are being complied with.

<sup>7</sup> The AICPA Quality Control Review Committee is preparing, for guidance of committee-appointed review teams, examples of programs that may be used in these reviews.

In selecting both the number and location of practice offices to be visited, the review team should consider the reviewed firm's previously furnished background information. The practice offices selected should be generally representative of the reviewed firm's accounting and auditing practice and, accordingly, should provide a cross section of offices, giving consideration to their size and geographic distribution. In addition, consideration should be given to the selection of recently merged or recently opened offices.

The number and location of practice offices to be selected will require the exercise of judgment by the review team. Considerations which may affect the number and location of practice offices selected for review would include (1) degree of centralization of accounting and auditing practice control and supervision, (2) significance of specialized industry practice, and (3) the review team's evaluation of the scope and adequacy of the reviewed firm's inspection program.

While the foregoing considerations preclude definitive guidelines, Exhibit A has been developed to assist a review team in selecting offices in the review of a multioffice firm.

#### ***Extent of Engagement Review.***

The objectives of the review of engagements are to evaluate (1) whether there has been compliance by the reviewed firm with its quality control policies and procedures and (2) whether the quality control policies adopted and procedures established by the reviewed firm are appropriately comprehensive and suitably designed for its accounting and auditing practice. To the extent necessary to achieve these objectives, the review of engagements should include review of financial statements, accountants' reports, working papers, and correspondence and should include discussion with professional personnel of the reviewed firm. The depth of review of working papers for particular engagements is left to the judgment of the reviewers; however, the review is directed primarily to the key areas of an en-

gagement to determine whether, in accordance with the reviewed firm's quality control policies and procedures, there were well-planned, appropriately executed, and suitably documented procedures that were performed on the engagement.

In connection with these engagement reviews, the review team may encounter indications of significant failures by the reviewed firm to reach appropriate auditing and reporting conclusions. In such situations, the review team should consider that it has not made an examination of financial statements in accordance with generally accepted auditing standards, nor does it have the benefit of access to client records, discussions with a client, or specific knowledge of a client's business. Therefore, in the absence of compelling evidence to the contrary, the review team should presume that representations as to facts contained in the working papers are correct. The review team should, however, pursue questions about auditing or reporting matters with the reviewed firm when it believes there may be a significant failure to reach appropriate conclusions in the application of generally accepted auditing standards or generally accepted accounting principles.

The review team should consider whether significant failures to reach appropriate auditing and reporting conclusions are indicative of significant deficiencies of the reviewed firm in complying with its quality control policies and procedures or of significant inadequacies in those policies and procedures. The pattern, pervasiveness, and significance of the failures noted should be considered by the review team in making its overall evaluation of the reviewed firm's system of quality control and compliance therewith.

Should the review team, during the conduct of the review, believe that the reviewed firm may have issued an inappropriate report on a client's financial statements, the review team captain shall promptly inform an appropriate authority within the reviewed firm. In such circumstances, it is the responsibil-

ity of the reviewed firm to determine what action should be taken.<sup>8</sup>

*Selection of Engagements*—The segment of the firm's accounting and auditing practice reviewed should be sufficient to provide the review team with reasonable assurance for its conclusions as to the appropriateness or suitability of the reviewed firm's quality control policies and procedures and compliance therewith.

The review team should select the engagements to be reviewed for each practice office to be visited based on accounting and auditing practice statistics and other data. If not previously obtained, the review team may wish to obtain information, such as the names of clients, types of industries, client size (for example, revenues, assets), publicly held, privately held or governmental, number of engagement hours, and names of the partner and supervisory personnel associated with the engagements.

Engagements selected for review should provide a reasonable cross section of the reviewed office's accounting and auditing practice; however, greater weight should be given to selecting engagements for publicly held clients in view of the public interest in these companies. An effort should be made to include engagements of most of the partners and other supervisory personnel in the reviewed office and to provide a diversity of types of engagements.

The number of engagements to be selected or the percentage of the firm's accounting and auditing hours to be reviewed will be affected by the size and nature of the reviewed firm's practice as well as the method of selection employed by the review team. While these considerations preclude definitive guidelines, Exhibit B has been developed to assist a review team in determining judgmentally the number of engagements or accounting and auditing hours to be covered.

<sup>8</sup> See *Codification of Auditing Standards and Procedures*, SAS 1 (New York: AICPA, 1973), sec. 561.

**COMPLETION OF THE REVIEW**

Prior to issuance of its report, the review team should communicate its conclusions to the reviewed firm. This communication would ordinarily take place at a meeting attended by the review team captain, the executive or supervisory committee (if applicable) and in-charge or other reviewers, as appropriate, and by appropriate individuals from the reviewed firm. The parties would discuss the review team's conclusions and any resulting impact on the opinion to be issued, recommendations (if any) for improvements in the reviewed firm's quality control policies and procedures, and other rele-

vant matters. The reviewed firm may decide to have recommendations for improvement furnished in writing by the review team captain.

For the review of a multioffice firm, the review team for a practice office would normally communicate the findings of its review to appropriate individuals at the office reviewed.

**REVIEW TEAM WORKING PAPERS**

The review team captain should furnish instructions to the review team as to the manner in which working papers and other notes relating to the review are to be accumulated during the course of the

review to facilitate summarization by the review team captain in completing the review.

Since reviews conducted under the program are not examinations of financial statements by independent auditors, there is no requirement for the review team to retain its working papers. For reviews conducted by a committee-appointed review team, working papers are retained only until such time as the report on the review has been filed with the AICPA or the period for filing the report has elapsed, whichever is earlier. For reviews conducted by other reviewing entities, arrangements as to disposition of working papers should be made.

These guidelines have been developed for guidance to review teams in the initial period of implementation of the program and are subject to review at a subsequent time to determine whether modifications are appropriate in the light of experiences in practice.

**EXHIBIT A**

The following guidelines, which should be read in conjunction with guidance on selection of offices included in the accompanying guide, may be considered for reviews of multioffice firms:

| Number of offices<br>in reviewed firm | Approximate number of offices<br>to be selected for review  |
|---------------------------------------|---|
| 2 to 15                               | Largest office plus 1 to 3 offices  |
| over 15                               | 15% to 25% of the reviewed firm's offices (the selected offices should contain similar percentages of the firm's professional personnel and the firm's accounting and auditing hours) |

**EXHIBIT B**

The following guidelines may be considered in determining judgmentally the percentage of a reviewed firm's total accounting and auditing hours to be selected for review:

| Number of offices<br>in reviewed firm | Percentage of reviewed firm's total accounting<br>and auditing hours to be reviewed |
|---------------------------------------|---|
| 1 to 15                               | 5% to 10%   |
| over 15                               | 3% to 6%  |

For example, if three offices of a ten-office firm were selected for review, engagements selected for review in those three offices should represent between 5% and 10% of the reviewed firm's total accounting and auditing hours.

The time required to review selected individual engagements is subject to variation depending on the size, nature, and complexity of the engagement, including engagements in specialized industries. For example, review time for smaller engagements would generally be proportionally greater than that required for larger engagements in relation to total hours for those engagements.

In performing the engagement review portion of the review, it can be anticipated that the time required by the review team for review of all engagements selected may be expected to vary from 1% to 3% of the aggregate hours incurred by the reviewed firm to perform these engagements.

## REPORTING ON QUALITY CONTROL COMPLIANCE REVIEWS

### THE REVIEW TEAM'S REPORT

The program provides that, upon completion of a quality control compliance review, the review team communicate its findings to the reviewed firm and promptly submit a written report to the reviewed firm. In order for the reviewed firm to become a participating firm in the program, or to continue as a participant, a report acceptable for participation in the program (see below) must be submitted by the reviewed firm to the AICPA. Failure to file an acceptable report will result in the reviewed firm's not becoming or not continuing as a participant in the program.

The report should be addressed to the partners, proprietor, stockholders, or officers of the reviewed firm. A report issued by a review team appointed by the Quality Control Review Committee, or by another entity that administers the program for the committee, should be signed by the review team captain (without reference to the captain's firm) and should contain the name of the review team's originating organization (such as the AICPA or state society of CPAs). A report by a review team formed by a CPA firm should be issued on the reviewing firm's letterhead and signed by the firm. The report should be dated as of the completion of the review.

The reviewed firm may advise its clients and its personnel of the results of the review and indicate that the report is on file at the AICPA. Copies of the report may be made available to a reviewed firm's clients, its personnel, and others in accordance with applicable rules of professional ethics.

### REPORT ACCEPTABLE FOR PARTICIPATION IN THE PROGRAM

A report issued by a review team that is acceptable for participation in the program (an "acceptable report") contains a statement of the scope of the review, a description of the general characteristics of a system of quality control, and the opinion (without qualification) of

the review team that the reviewed firm's quality control system was appropriately comprehensive and suitably designed for the firm, adequately documented, communicated to professional personnel, and was being complied with to provide reasonable assurance that the firm conforms with the guidelines of the profession for firms participating in the program.

An example of an acceptable report is presented as the Appendix of this document.

### REPORTING CONSIDERATIONS

The review team's evaluation of whether a reviewed firm's quality control system and compliance therewith conform with the guidelines of the profession requires both an understanding of the elements of quality control and the exercise of professional judgment as to their application to an accounting and auditing practice. Because of the absence of quantitative measurement criteria, the evaluation of the significance of perceived deficiencies in the system of quality control or compliance therewith may be more difficult than the evaluation of the materiality of exceptions noted in financial reporting matters. In determining whether a review team will issue an acceptable report, the review team should consider factors such as those that follow.

**Deficiencies.** The deficiencies noted should be considered for their significance in relation to the reviewed firm's (1) quality control policies and procedures, (2) organizational structure, and (3) nature of practice.

A deficiency noted in certain quality control policies and procedures may be partially or wholly offset by other policies or procedures. The review team should consider the interrelationships among the elements of quality control and weigh deficiencies against other compensating policies and procedures.

**Compliance.** Compliance, as used in this document, means adherence to a prescribed policy or

procedure in the substantial majority of situations; it does not imply adherence to a prescribed policy or procedure in every case. Variance in individual performance and professional interpretation affects the degree of compliance with a firm's prescribed quality control policies and procedures; therefore, adherence to all policies and procedures in every case may not be possible, nevertheless a high degree of compliance is to be expected. The review team should consider the nature, significance, and frequency of instances of noncompliance noted in the review in evaluating whether the reviewed firm is in compliance with its quality control policies and procedures.

In considering instances of noncompliance with prescribed quality control policies and procedures that could affect the review team's report, the review team should discuss with the reviewed firm whether the quality control policies and procedures in question exceed policies and procedures that would be required in the circumstances to achieve the objectives of a quality control system and participation in the program. In such instances, if the review team concludes that the quality control policies and procedures in question exceed those required for participation in the program, its report should be based on compliance by the reviewed firm with those policies and procedures required to provide reasonable assurance of conformity with the guidelines of the profession for firms participating in the program.

### CIRCUMSTANCES RESULTING IN A REPORT UNACCEPTABLE FOR PARTICIPATION IN THE PROGRAM

A report unacceptable for purposes of participation in the program (an "unacceptable report") should be issued when there is a significant scope limitation or when the review team concludes that deficiencies noted are of such significance that the reviewed firm's quality control system or compli-

ance therewith do not provide reasonable assurance that the firm conforms with the guidelines of the profession for firms participating in the program.

Circumstances that ordinarily would result in an unacceptable report are as follows:

1. The scope of the review is limited by conditions that preclude the application of one or more review procedures considered necessary.
2. The review discloses significant deficiencies (see discussion of "deficiencies" above) in the quality control policies and procedures prescribed for the firm's accounting and auditing practice.
3. The review discloses a significant lack of compliance (see discussion of "compliance"

above) with the firm's quality control policies and procedures.

In those instances in which the review team determines that an unacceptable report is required, the reasons should be adequately disclosed.<sup>9</sup>

#### **ENGAGEMENTS DISCONTINUED PRIOR TO COMPLETION**

In the event that a review is discontinued prior to completion, the review team should consider advising the reviewed firm in writing of the discontinuance. The review

<sup>9</sup> It is anticipated that few unacceptable reports will be filed with the AICPA by reviewed firms since filing such reports will not permit a reviewed firm to participate in the program, and the reviewed firm is under no obligation to file the report with the AICPA.

team may wish to communicate any major concerns to the reviewed firm.

#### **DISAGREEMENT WITHIN COMMITTEE-APPOINTED REVIEW TEAMS**

A disagreement regarding the type of report to be issued may arise among members of an executive committee or supervisory committee (where applicable), or review team members who have knowledge of the overall findings of the review. When review team members are unable to resolve such a disagreement, the matter should be referred to the Quality Control Review Committee of the AICPA for resolution.<sup>10</sup>

<sup>10</sup> As provided in the program, disagreements between a review team and reviewed firm may be submitted to the Quality Control Review Committee for resolution.



## APPENDIX

## REPORT ACCEPTABLE FOR PARTICIPATION IN THE PROGRAM

To the Partners  
Jones, Smith & Co.

We have reviewed the system of quality control for the accounting and auditing practice of Jones, Smith & Co. in effect for the (period) ended June 30, 1978. Our review was conducted in conformity with guidelines for quality control compliance reviews promulgated under the Voluntary Quality Control Review Program for CPA Firms of the American Institute of Certified Public Accountants. We tested compliance with the firm's quality control policies and procedures [at the firm's executive office and at selected practice offices in the United States]<sup>11</sup> to the extent we considered appropriate. These tests included the application of the firm's policies and procedures on selected accounting and auditing engagements. [We tested the supervision of portions of engagements performed outside the United States.]<sup>12</sup>

A firm's system of quality control encompasses its organizational structure and the policies adopted and procedures established to provide reasonable assurance that it conforms with professional standards in the conduct of its accounting and auditing practice. Professional standards are expressed in terms of broad concepts and objectives rather than detailed procedures, and their application requires the exercise of professional judgment in a variety of circumstances. The extent of a firm's quality control policies and procedures and the manner in which they are implemented will depend upon a variety of factors, such as the size and organizational structure of the firm, the nature of its practice, and its philosophy as to the degree of operating autonomy appropriate for its people. Variance in individual performance and professional interpretation affects the degree of compliance with a firm's prescribed quality control policies and procedures; therefore, adherence to all policies and procedures in every case may not be possible, but compliance does require adherence to a prescribed policy or procedure in the substantial majority of situations. In performing our review, we have given due regard to the foregoing conditions.

In our opinion, the system of quality control for the accounting and auditing practice of Jones, Smith & Co. for the (period) ended June 30, 1978, was appropriately comprehensive and suitably designed for the firm, adequately documented, communicated to professional personnel, and was being complied with during the period to provide reasonable assurance that the firm conforms with the guidelines of the profession for firms participating in the Voluntary Quality Control Review Program for CPA Firms of the American Institute of Certified Public Accountants.

City, State  
Date

William Brown  
Team Captain  
AICPA Review  
Team

[ for review by  
AICPA review  
team ]

Johnson & Co.

[ for review by  
a firm ]

<sup>11</sup> To be included, as appropriate, for reviews of multioffice firms.

<sup>12</sup> To be included for reviewed firms with offices, correspondents, or affiliates outside the United States. Appropriately modified wording should be used if the reviewed firm uses correspondents or affiliates domestically, if significant to the scope of the review.

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