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Private Companies Practice Section reference manual

Karen H. Jones

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PRIVATE COMPANIES PRACTICE SECTION REFERENCE MANUAL

**ORGANIZATIONAL DOCUMENTS
STANDARDS FOR PEER REVIEW
ADMINISTRATION**

**PRIVATE COMPANIES PRACTICE SECTION
REFERENCE MANUAL**



**Division for
CPA Firms**
AICPA



**Division for
CPA Firms**
AICPA

018082

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Division of CPA Firms
Private Companies Practice Section

PCPS REFERENCE MANUAL

Organization With Membership Requirements
Standards for Peer Reviews
Administrative and Other Peer Review Procedures

Prepared by
Committees of the
Private Companies Practice
Section

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Section I

PRIVATE COMPANIES PRACTICE SECTION OF THE AICPA DIVISION FOR CPA
FIRMS

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ORGANIZATIONAL STRUCTURE AND FUNCTIONS OF THE PRIVATE COMPANIES PRACTICE SECTION OF THE AICPA DIVISION FOR CPA FIRMS

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Organizational Structure and Functions of the Private Companies Practice Section**Source of Authority**

- .01 The section was established by a resolution of the Council of the AICPA adopted on September 17, 1977.

Name

- .02 The name of the section shall be the "Private Companies Practice Section" of the AICPA Division for CPA Firms.

Objectives

- .03 The objectives of the section shall be to achieve the following:
- a. Improve the quality of services by CPA firms to private companies through the establishment of practice requirements for member firms.
 - b. Establish and maintain an effective system of self-regulation of member firms by means of mandatory peer reviews, required maintenance of appropriate quality controls, and the imposition of sanctions for failure to meet membership requirements.
 - c. Provide a better means for member firms to make known their views on professional matters, including the establishment of technical standards.

Membership**Eligibility and Admission of Members**

- .04 All CPA firms, a majority of whose partners, shareholders, or proprietors are members of the AICPA, are eligible for membership in the section. To become a member, a firm must submit to the section a written application agreeing to abide by all of the requirements for membership and submitting such nonfinancial information about the firm as the executive committee may require.
- .05 The membership of the section shall consist of all firms which meet with the admission requirements and continue to maintain their membership in good standing.

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Companies Practice Section**

Termination of Members

.06 Membership of a CPA firm may be terminated

- a. By submission of a resignation providing the firm is not the subject of a pending investigation or recommendation of the peer review committee for sanctions or other disciplinary action by the executive committee.
- b. By action of the executive committee for failure to adhere to the requirements of membership. (See Appendix A, PCPS §1000.37 and Appendix C, PCPS §1000.39.)

Requirements of Members

.07 Member firms shall be obligated to abide by the following:

- a. Ensure that a majority of the members¹ of the firm are CPAs, that the firm can legally engage in the practice of public accounting, and that each proprietor, shareholder, or partner of the firm residing in the United States and eligible for AICPA membership is a member of the AICPA.
- b. Adhere to quality control standards established by the AICPA.
- c. Submit to and pay for peer reviews of the firm's accounting and audit practice every three years or at such additional times as designated by the executive committee, the reviews to be conducted in accordance with review standards established by the section's peer review committee.² (See Appendix B, PCPS §1000.38 and Appendix C, PCPS §1000.39.)

¹ As used here, members refers to partners, shareholders, and proprietors.

² Firms that issue compilation or review reports but perform no audits may elect to meet this requirement by submitting to a report review conducted in accordance with guidelines established by the section's peer review committee.

- d. 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:³
- (1) Participate in at least 120 hours every three years, but not less than 20 hours every year, or
 - (2) 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.
- e. Pay dues as established by the executive committee (Appendix E, PCPS §1000.41), 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 peer review committee in connection with its duties, including disciplinary proceedings; and comply with any sanction which may be imposed by the executive committee.
- f. File with the section for each fiscal year of the U.S. firm (covering offices in the United States and its territories) the following information, within 90 days of the end of such fiscal year, to be open to public inspection:
- (1) Form of business entity (for example, proprietorship, partnership, or corporation)
 - (2) Name of (a) managing partner or equivalent, and (b) person to contact at the firm concerning Division membership and other matters
 - (3) Number and location of offices
 - (4) Month in which the firm's fiscal year ends
 - (5) Total number of (a) proprietors, partners, or shareholders, and non-CPAs with parallel status and (b) proprietors, partners and shareholders that are CPAs

³ See PCPS §6000, "Continuing Professional Education Requirements," for additional information about the continuing professional education requirement and the manner in which compliance is to be measured.

Organizational Structure and Functions of the Private Companies Practice Section

- (6) Total number of CPAs (including proprietors, partners, shareholders, and staff)
- (7) Total number of professional staff (including proprietors, partners, or shareholders)
- (8) Total number of personnel [including item (7), above]
- (9) Disclosure regarding pending litigation as required under generally accepted accounting principles and indicating whether such pending litigation is expected to have a material effect on the firm's financial condition or its ability to serve clients
- (10) Month in which the firm's "educational year" ends. (The educational year is defined in PCPS §6000.03, "Continuing Professional Education Requirements.")
- (11) Number of SEC clients for which the firm is principal auditor-of-record; for this purpose, series of unit investment trusts and series of limited partnerships sponsored by the same entity shall be treated as one SEC client

Governing Bodies

- .08 The activities of the section shall be governed by an executive committee having senior status within the AICPA with authority to carry out the activities of the section. Such activities shall not conflict with the policies and standards of the AICPA.
- .09 At the discretion of the executive committee, all activities of the section may be subject to the oversight and public reporting thereon by a public oversight board appointed by the executive committee with the approval of the AICPA Board of Directors.

Executive Committee

- .10 The executive committee shall be named the "Private Companies Practice Executive Committee".

Composition and Terms

- .11 The executive committee shall be composed of twenty-one AICPA members, the majority of whom are from firms that are members of the private companies practice section.
- .12 The terms of executive committee members shall be for three years with initial staggered terms to provide for seven expirations each year.

- .13 Executive committee members shall continue in office until their successors have been appointed.

Appointment

- .14 The members of the executive committee shall be appointed by the chairman of the AICPA Board of Directors with the approval of the board and the concurrence of the executive committee. Appointments shall adhere to the principle that the executive committee should include individuals with experience and knowledge in the management of an accounting practice committee and in the private companies practice section, including its technical issues and peer review committees. The executive committee should include persons whose firms are not members of the private companies practice section provided, however, that only members of the executive committee whose firms are members of the PCPS member section shall be eligible to vote on section matters.

Election of Chairman

- .15 The chairman of the executive committee shall be elected from among its members to serve at the pleasure of the executive committee but in no event for more than three one-year terms.

Responsibilities and Functions

- .16 The executive committee shall represent, act as an advocate for, and provide service to benefit, all medium sized and small firms by, among other activities, providing practice-management services through the management of an accounting practice committee and representing those firms' interests on professional issues, primarily through the technical issues committee, and, with respect to the section—
- a. Establish general policies for the section and oversee its activities.
 - b. Amend requirements for membership as necessary, but in no event shall such requirements be designed so as to unreasonably preclude membership by any CPA firm.
 - c. If necessary, establish budgets and dues requirements to fund activities of the section such as special projects or a public oversight board. Staffing of the section will be provided for in the AICPA general budget. Any dues shall be scaled in proportion to the size of member firms.
 - d. Determine sanctions to be imposed on member firms for failure to comply with the section's membership requirements,

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ordinarily through the appointment of hearing and appeals panels.

- e. Receive, evaluate, and act upon other complaints received with respect to actions of member firms.
- f. If the executive committee decides to appoint a public oversight board, select public persons to serve on it and establish its functions and compensation with the approval of the AICPA Board of Directors.
- g. Appoint persons to serve on such committees and task forces as necessary to carry out the functions of the section.
- h. Make recommendations to other AICPA boards and committees for their consideration.
- i. Provide comment to the public oversight board and the SEC practice section on matters under the board's consideration that would affect members of the private companies practice section.
- j. Organize and conduct annual regional conferences covering appropriate practice subjects.

Quorum, Voting, Meetings, and Attendance

- .17 A majority of the members of the executive committee or their designated alternates must be present to constitute a quorum.
- .18 Affirmative votes of a majority of the members of the executive committee shall be required for action on all matters.
- .19 Meetings of the executive committee shall be held at such time and in such locations as the chairman shall determine.
- .20 Representatives of member firms of the section may attend meetings of the executive committee as observers under rules established by the executive committee except when the committee is considering disciplinary matters.
- .21 Determinations of hearings and appeals panels with respect to the imposition of sanctions on member firms will be decided by majority vote of the members of such panels, in accordance with the Rules of Procedure established for such proceedings.

Public Oversight Board

Type of Members, Selection, and Appointment

- .22 If it chooses, the executive committee may, with the approval of the AICPA Board of Directors, select and appoint a five-member public oversight board and establish its functions and compensation. Members of such board shall be drawn from among prominent individuals of high integrity and reputation including, but not limited to, former public officials, lawyers, bankers, securities industry executives, educators, economists, and business executives.

Chairman and Terms of Members

- .23 The chairman shall be appointed by the executive committee.
- .24 The terms of members shall be for a period of three years renewable at the pleasure of the executive committee.

Responsibilities and Functions

- .25 The executive committee may request a public oversight board to—
- a. Monitor and evaluate the activities of the peer review and executive committees to ensure their effectiveness.
 - b. Determine that the peer review committee is ascertaining that firms are taking appropriate action as a result of peer reviews.
 - c. Conduct continuing oversight of all other activities of the section.
 - d. Make recommendations to the executive committee for improvements in the operations of the section.
 - e. Publish periodic reports on results of its oversight activities.
 - f. Engage staff to assist in carrying out its functions.
 - g. Have the right for any or all of its members to attend any meetings of the executive committee.

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Peer Reviews

Review Requirements

- .26 Peer reviews of member firms shall be conducted every three years or at such additional times as designated by the executive committee. (See Appendix B, PCPS §1000.38.)

Peer Review Committee

Composition and Appointment

- .27 The peer review committee shall be a continuing committee appointed by the executive committee and shall consist of not less than 15 individuals selected from member firms.

Responsibilities and Functions

- .28 The peer review committee shall—
- a. Administer the program of peer reviews for member firms.
 - b. Establish standards for conducting reviews.
 - c. Establish standards for reports on peer reviews and publication of such reports.
 - d. Request the chairman of the executive committee to appoint a hearing panel when it is believed sanctions should be imposed on a member firm for failure to comply with membership requirements.
 - e. Keep appropriate records of peer reviews which have been conducted.

Peer Review Objectives

- .29 The objectives of peer reviews shall be to determine that
- a. Member firms, as distinguished from individuals, are maintaining and applying quality controls in accordance with standards established by the AICPA. Reviews for this purpose shall include a review of working papers rather than specific "cases." (The existence of "cases" in a firm might raise questions concerning its quality controls.)
 - b. Member firms are meeting membership requirements.

Sanctions Against Firms

Authority to Impose Sanctions

.30 The executive committee shall have the authority to impose sanctions on member firms. Ordinarily such sanctions shall be determined by hearing and appeals panels operating under Rules of Procedure designed to assure due process to firms subject to such proceedings.

Types of Sanctions

.31 The following types of sanctions may be imposed on member firms for failure to maintain compliance with the requirements for membership:

- a. Require corrective measures by the firm including consideration by the firm of appropriate actions with respect to individual firm personnel
- b. Additional requirements for continuing professional education
- c. Accelerated or special peer reviews
- d. Admonishment, censure, or reprimand
- e. Monetary fines
- f. Suspension from membership
- g. Expulsion from membership

Financing and Staffing of Section

Section Staff and Meeting Costs

.32 The president of the AICPA shall appoint a staff director and assign such other staff as may be required by the section.

.33 The costs of the section staff and normal meeting costs shall be paid out of the general budget of the AICPA.

Public Oversight Board and Special Projects

.34 The costs of a public oversight board, if appointed, and its staff shall be paid out of the dues of the section.

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.35 The costs of special projects shall be paid out of the dues of the section.

Relationship to Other AICPA Segments

.36 Nothing in the organizational structure and functions of this section shall be construed as taking the place of or changing the operations of existing senior committees of the AICPA or the status of individual CPAs as members of the AICPA.

**.37 APPENDIX A—Automatic Suspension and Termination of Members That
Fail to Meet Certain Membership Requirements**

WHEREAS: Member firms of the private companies practice section are required to abide by the requirements of membership, which include, among other things, requirements to file certain information with the section for each fiscal year, to pay dues as established by the executive committee, and to cooperate with the peer review committee in connection with its duties; and

WHEREAS: The executive committee is authorized to establish general policies for the section and oversee its activities; and

WHEREAS: Membership of a CPA firm may be terminated by action of the executive committee for failure to adhere to the requirements of membership;

IT IS HEREBY RESOLVED THAT:

Membership in the private companies practice section shall be suspended thirty days after a firm has been notified by certified mail that it is in default of its obligation to:

- File its annual report to the section;
- Pay its dues;
- File requested information with the peer review committee incident to arrangements for a required peer review;
- Have a peer review by the required date; or
- Pay in full the fees and expenses of the review team appointed by the peer review committee within 60 days of the date when the peer review was accepted by the peer review committee.

The firm shall be automatically dropped from membership 90 days after the date of the suspension if the failure is not sooner corrected.

BE IT FURTHER RESOLVED THAT:

Membership in the private companies practice section shall be suspended thirty days after a firm has been notified by certified mail that it is in default of its obligations under the peer review program to:

- File the report, letter of comments, if any, and its response to all matters discussed in the report and letter of comments;

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Cooperate with the peer review committee in connection with its duties, including completion of required follow-up actions and any disciplinary proceedings.

The firm's membership shall be automatically terminated 90 days after the date of the suspension if the failure is not sooner corrected. However, the peer review committee may at its discretion decide to request that the Chairman of the executive committee appoint a hearing panel to consider whether sanctions should be imposed on the firm and, whether a hearing is held or not, the firm will have the right to appeal to the executive committee for a review of the finding. Further, termination of a firm's membership, whether a hearing is held or not, shall be reported in an AICPA membership periodical.

This resolution shall be retroactively applied to firms in default of any of the aforementioned obligations on the date of the resolution's adoption by the executive committee.

.38 APPENDIX B—Timing of Peer Reviews

Initial Peer Review

1. General rules: Except as described in the following paragraphs, field work on the initial peer review of any firm joining the section must begin within 18 months from the date the firm is accepted as a private companies practice section (PCPS) member.
2. If a firm has had a consulting review six months before or after joining the section, or has had a quality review within 12 months of joining the section and is not taking the special election described below, the field work on the firm's initial peer review must begin within 24 months from the date the firm is accepted as a PCPS member.
3. If the firm was enrolled in the AICPA quality review program prior to joining the section and did not have a review under that program, its initial PCPS peer review must begin by the date set under the quality review program or ninety days after joining PCPS, whichever comes later. However, if the quality review due date is beyond the firm's eighteenth month of membership in the PCPS, then the general rules as described in the first two paragraphs above would apply.
4. If the firm was a member of the SEC practice section (SECPS) prior to joining the PCPS, its initial PCPS peer review must begin by the date set under the SECPS program or 90 days after joining the PCPS, whichever comes later.

Special Election - Previous Quality Review

5. A firm that has had a quality review under the AICPA quality review program may elect to have that review treated as the equivalent of a PCPS review for the purpose of determining the timing of the firm's initial peer review as a PCPS member under the guidelines for "Subsequent Peer Reviews," provided that with its membership application the firm submits to the section for inclusion in its public files¹ —

¹ Until such a firm has had a peer review that has been conducted under the peer review standards of the private companies or SEC practice sections of the AICPA Division for CPA Firms and that review has been accepted by the cognizant peer review committee, the firm will not be eligible to perform PCPS peer reviews, nor will its personnel be eligible to serve as PCPS team captains.

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- a. The report, letter of comments, if any, the firm's response thereto, and the letter of acceptance issued by the entity administering the quality review (the AICPA or a participating state CPA society).
- b. Evidence of satisfactory completion of any action agreed to pursuant to the administering entity's consideration of the results of that quality review.

Previous PCPS Members

6. If the firm has been a member of the section during the four years preceding its reacceptance and has not had a quality review or SECPS peer review in the intervening period, a condition of reacceptance will be that the peer review field work be scheduled to start within 90 days of the firm's reacceptance, or by the date the original peer review was to commence, whichever is later. (See Appendix D, PCPS §1000.40.)

Subsequent Peer Reviews

7. Field work on a member firm's subsequent peer review must begin within three years and six months after the end of the period covered by the previous peer review. Although it is expected that a firm ordinarily will not change its review year, a firm may do so without the peer review committee's prior approval, provided that the new review year-end is not beyond three months of the previous review year-end and provided that the field work still begins in accordance with the requirement in the preceding sentence.²

² Guidance on selecting the review year is discussed in Appendix B, PCPS §2000.129, "Standards for Performing and Reporting on Peer Reviews." Applying that guidance, the typical local practitioner, in consultation with the peer reviewer, would select a peer review year that ends approximately three to four months before the date on which the peer reviewers begin their work. In the large majority of cases, the peer review will have been completed within six months of the date of the peer review year-end, and the report, letter of comments, if any, and the firm's response thereto will have been submitted to the section for consideration by the peer review committee.

.39 APPENDIX C—Statement of Policy on the Peer Review Program

1. A peer reviewer is ordinarily expected to issue the peer review report and letter of comments, if any, within 30 days of the exit conference. The reviewed firm is ordinarily expected to submit its report, and its letter of comments and response thereto, if applicable, within 30 days of the date the report and letter of comments were issued. When these timing guidelines are not met, an AICPA staff person or a member of the peer review committee shall determine the reasons for the delay and act accordingly. If in the opinion of such person, after consultation with the chairman of the peer review committee—
 - a. The delay arises from an unresolved problem or disagreement in the review, an attempt will be made to resolve the matter. At that time, the reviewed firm will be advised that it is under investigation pursuant to PCPS §1000.06a.
 - b. The delay arises from a failure to perform the peer review in a timely, professional manner, the peer review team captain will be advised that the peer review committee will be asked to decide at its next meeting whether to refer the matter to the AICPA professional ethics division as a violation by the peer review team captain of Rule 501 of the AICPA Rules of Conduct. (If the review team was organized by a member firm or by a sponsoring association or state CPA society, the managing partner of the firm or the appropriate association or society representative will be alerted to the problem before the matter is formally voted on by the peer review committee.) In reaching such a decision, the committee will ordinarily give the peer review team captain a grace period of not less than 15 days to remedy the problem before the referral is made to the professional ethics division. A representation that the problem will be remedied is ordinarily not sufficient to forestall referral to the professional ethics division. Further, in these circumstances the committee may determine that a firm no longer has the qualifications to be a reviewing firm or that the sponsoring association or state CPA society should no longer be authorized to arrange and carry out peer reviews.
 - c. The delay arises from an unreasonable failure by the reviewed firm to comply with its obligations under the peer review standards, the reviewed firm will be advised that it is under investigation for purposes of PCPS §1000.06a, and that the automatic suspension and termination procedures discussed in Appendix A, PCPS 1000.37, will apply. A representation that the document will be submitted is not

**Organizational Structure and Functions of the Private
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sufficient to forestall the automatic suspension and termination procedures.

2. Also, when the peer review committee or its staff learns in whatever manner from a peer reviewer, the reviewed firm, or others that the peer review report for a given member firm has been or may be qualified or that the peer reviewer believes that the reviewed firm may have issued an inappropriate report on a client's financial statements, the matter shall be investigated by the peer review committee in the manner and to the extent it deems appropriate. (A formal notification to the reviewed firm of such investigation is not required until such time, if any, that the peer review committee decides to request that the Chairman of the executive committee appoint a hearing panel to consider whether sanctions should be imposed on the member firm.) Pursuant to PCPS §1000.6a, a member firm that is under investigation by the peer review committee is not free to resign until the matter is resolved and until the firm has taken the corrective actions, if any, deemed necessary by the peer review committee. Receipt of a resignation in these circumstances, coupled with a failure to cooperate in resolving the matter, ordinarily will cause the peer review committee to decide to conduct a hearing for the purpose of determining whether to recommend sanctions against the firm.

.40 APPENDIX D—Reinstatement of Members

1. The executive committee has determined that membership of a CPA firm that has been terminated may be reinstated by either—
 - a. Complying with the admission requirements for new members, if the termination occurred by resignation; or
 - b. Complying with the admission requirements for new members and obtaining the approval of the executive committee, if the termination was imposed as a sanction.
2. If the firm has been a member of the section during the last four years, a condition of reacceptance will be that the peer review field work be scheduled to start within 90 days of the firm's reacceptance or by the date the original peer review was to commence, whichever is later.

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Companies Practice Section**

.41 APPENDIX E—Private Companies Practice Section Dues

1. The Private Companies Practice Executive Committee established the following dues structure:
 - a. Dues are \$25 for each CPA in the firm, with a minimum of \$25 and a maximum of \$500 per firm.
 - b. Dues will be billed annually as of January 1 and will be determined based on the number of CPAs in the member firm as shown on its most recent annual report. Dues will be prorated on a monthly basis for new members.

Section II

PRIVATE COMPANIES PRACTICE SECTION PEER REVIEW PROGRAM STANDARDS

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PCPS
2000

**Standards for Performing
and Reporting on
Peer Reviews**

Section 2000

**Standards for Performing and
Reporting on Peer Reviews**

NOTICE TO READERS

This section entitled "Standards for Performing and Reporting on Peer Reviews" is amended from time to time by the members of the peer review committee of the private companies practice section of the AICPA Division for CPA Firms (the committee). The committee is authorized to establish standards for performing and reporting on peer reviews in the section entitled "Organizational Structure and Functions of the Private Companies Practice Section of the AICPA Division for CPA Firms" adopted by resolution of Council of the AICPA.

Reviewers shall adhere to the standards contained herein when conducting a review under the section's peer review program. The committee shall review these standards from time to time to determine whether any modification, update, or amendment is required in light of future developments in practice.

PRIVATE COMPANIES PRACTICE SECTION

Peer Review Committee (February 1991)

Charles J. McElroy, Chairman
Sheila M. Birch
Dean L. Burdsall
Donald M. Dale
Philip J. DeCaprio
Barbara Hutson Gonzales
William H. Hawthorne Jr.
David P. Hostetler
David K. Johnson
Douglas C. Koval
Walter P. Kunz
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Manager, Quality Review

STANDARDS FOR PERFORMING AND REPORTING ON PEER REVIEWS

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Standards for Performing and Reporting on Peer Reviews**Introduction**

- .01 The membership requirements of the private companies practice section (PCPS) of the AICPA Division for CPA Firms provide that a member firm must adhere to quality control standards established by the AICPA and have a peer review of its accounting and auditing practice and its compliance with section membership requirements every three years or at such additional times as designated by the section's executive committee. (See PCPS §1000.07 and PCPS §1000.26-.29.) The peer reviews so conducted are subject to the administrative control of the peer review committee (**the committee**), which may, at its discretion, appoint an oversight or evaluation panel to evaluate any peer review conducted for the purposes of meeting membership requirements.
- .02 This section contains the standards for performing and reporting on peer reviews for the PCPS. **Peer reviews** intended to meet the section's membership requirements for mandatory peer review must be conducted in accordance with these standards.¹ (PCPS §2600, "Guidelines for a Report Review," provides performance and reporting standards for reviews of firms which perform compilations and reviews but no audits.)
- .03 If a firm is a member of both the SEC practice section and the private companies practice section, a peer review performed to meet the SECPS membership requirements fulfills the PCPS membership requirements.²
- .04 As used herein, the term **review team** refers to a team that is—
- a. Appointed by the committee.
 - b. Formed by a member firm engaged by the firm under review (a firm-on-firm review).

¹ The terms **review** and **peer review** are used interchangeably in this section.

² If a PCPS member firm joins the SEC practice section, its next peer review will be due by the date its PCPS peer review was due, unless the firm is granted an extension of time by the SECPS peer review committee.

- c. Formed by a state CPA society or association of CPA firms authorized by the committee to arrange and carry out peer reviews.
- .05 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 the firm with reasonable assurance of conforming with professional standards in the conduct of its accounting and auditing practice.³
- .06 The quality control policies and procedures adopted by a member firm depend in part upon the firm's organizational structure, including such factors as its size, the degree of operating autonomy allowed its personnel and its practice offices, the nature of its practice, and its administrative controls.
- .07 A member firm is required to make available to the review team a description of the quality control policies and procedures incorporated in its quality control system. The system of quality control maintained by a firm encompasses the firm's organizational structure and the policies adopted and procedures established to provide the firm with reasonable assurance of conforming with professional standards in the conduct of the firm's accounting and auditing practice. This requirement is met by furnishing a quality control policies and procedures questionnaire.⁴
- .08 The standards encompassed herein are applicable to reviewing entities (**review teams**) and to individual reviewers (**review team members**) who perform or are involved in performing peer reviews. They also impose obligations on firms being reviewed.

³ **Accounting and auditing practice**, as referred to in this section, is limited to all auditing, and all accounting, review and compilation services covered by generally accepted auditing standards, standards for accounting and review services, standards for accountants' services on prospective financial information, and Government Auditing Standards issued by the U.S. General Accounting Office (the "Yellow Book").

⁴ The quality control policies and procedures questionnaire is contained in the Peer Review Manual, "Peer Review Program Guidelines," section 1.

Performing Peer Reviews**Objectives of the Peer Review**

- .09 A peer review is intended to evaluate 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 (Appendix A, PCPS §10,000, "Statement on Quality Control Standards 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. The reviewed firm was complying with the section's membership requirements.
- .10 Upon completing a peer review, the review team communicates its findings to the reviewed firm and prepares a written report in accordance with the standards for reporting on peer reviews. The review team also prepares a letter of comments when applicable.

General Considerations**Confidentiality**

- .11 A peer review is to be conducted with due regard for the confidentiality requirements set forth in the AICPA Code of Professional Conduct. Information concerning the reviewed firm or any of its clients that is obtained as a consequence of the review is confidential and should not be disclosed by review team members to anyone not associated with the review.⁵
- .12 It is the responsibility of a reviewed firm to take such measures, if any, as may be necessary to satisfy its obligations concerning client confidentiality. Rule 301 of the AICPA Code of Professional Conduct contains an exception to the confidentiality requirements so that review of a member's professional practice under AICPA or state CPA society authorization is not prohibited. Some state statutes or ethics rules promulgated by state boards of accountancy may, however,

⁵ The expression **associated with the review**, as used in this section, includes members, designees, and staffs of the PCPS executive and peer review committees.

not clearly provide a similar exception regarding client confidentiality.⁶ 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.

Independence

- .13 Independence with respect to the reviewed firm must be maintained by a reviewing firm, by review team members, and by consultants who may participate in the review.
- .14 The AICPA Code of Professional Conduct does not specifically consider relationships between reviewers, reviewed firms, and clients of reviewed firms. However, the concepts in the code pertaining to independence should be considered.
- .15 Reciprocal reviews are not permitted. This prohibition is applicable to a reviewing firm. In addition, when the review is conducted by a committee, association of CPA firms, or state CPA society appointed review team, no professional of the reviewed firm may serve as a reviewer of the firms whose personnel participated in the reviewed firm's most recent peer review.⁷
- .16 The review team members and, in the case of a firm-on-firm review, the reviewing firm and its personnel, are not precluded from owning securities of 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 because independence would be considered to be impaired. In addition, the effect on independence of family relationships (spouses, close relatives) and other relationships and the possible resulting loss of the appearance of independence must be considered when assigning team members to review individual engagements.
- .17 In assessing the possibility of an impairment of independence, reviewing firms should consider any family or other relationships between the senior managements at organizational and

⁶ The AICPA maintains current information on states that do not clearly provide an exception to the confidentiality requirements discussed in this section.

⁷ For example, assume member firm A is reviewed by a team composed of a team captain who is a partner of member firm B, a partner of member firm C, and a manager from member firm D; the review is completed on December 1, 1990. No professional in member firm A may be assigned as a member of a team reviewing member firms B, C, or D until after November 30, 1993.

functional levels of the reviewing firm and the firm to be reviewed.

- .18 Some firms perform engagement correspondent work for other firms. The correspondent firm's fee may be paid either by the referring firm or directly by the client. In either situation, if the fees for the correspondent work are material to the reviewed firm or the reviewing firm or the firm of any member of the review team, independence for purposes of this program is impaired.
- .19 Some reviewers or their firms may have continuing arrangements with other firms whereby fees, office facilities, or professional staff are shared. In these situations, independence for purposes of the program is impaired.⁸

Conflict of interest

- .20 A reviewing firm or a review team member should not have a conflict of interest with respect to the reviewed firm or with respect to those of its clients that are the subject of engagements reviewed.

Competence

- .21 In determining the composition of a review team, consideration should be given to the areas to be reviewed and the experience required for various segments of the review.
- .22 A review team must have current knowledge of the type of practice to be reviewed, including appropriate experience in the industries in which the reviewed firm practices. If the clients of the reviewed firm include any that must file periodic reports with regulatory bodies, the review team must include member(s) having knowledge of the current rules and regulations of such regulatory bodies.

Due care

- .23 Due care is to be exercised by the review team in the performance of the review and in the preparation of the report and, if applicable, the letter of comments. Due care for peer 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.

⁸ See Appendix A, PCPS §2000.128, "Interpretation: Independence and Conflict of Interest," for additional guidance and examples of how the independence requirements are to be interpreted.

Organization of the Review Team

- .24 A committee, association of CPA firms or state CPA society appointed review team must be organized so that any individual firm does not provide more than one member of a review team.
- .25 A review team consists of one or more individuals, one of whom is designated as the team captain. A team captain directs the organization and conduct of the review, supervises other reviewers, and is responsible for the preparation of a report on the review and, if applicable, a letter of comments. In some instances, a review team may consist of only one reviewer because of the size and nature of practice of the firm to be reviewed. For the purposes of this program, an individual serving as a sole reviewer shall be called a team captain.
- .26 As necessary, the team captain may designate a member of the review team to supervise the reviewers at each organizational level of the reviewed firm. In the case of the review of a multi-office firm, the reviewers visiting a selected practice office should be under the direction, at that location, of a partner currently involved in the accounting and auditing function who supervises the conduct of the review and the work performed at that location (subject to the overall direction of the team captain). The peer review program assumes that the review team captain will have significant involvement in the conduct of the review, including the planning of the review, and will attend the firm-wide exit conference. (For reviews of multi-office firms, the overall team captain may not consider it necessary to attend the exit conference of every office visited; however, the work of review teams at each organizational level should be supervised by a partner.) In any case, the review team captain should be involved in discussions of significant findings on the review, and should interact with the reviewed firm and the review team during the conduct of the review.

Qualifications for Service as a Reviewer

- .27 The nature and complexity of a peer review require the exercise of professional judgment. Accordingly, an individual serving as a reviewer must be a member of the AICPA and licensed to practice as a CPA and must possess current knowledge of accounting and auditing matters. In addition, a reviewer must have at least five years of experience in the practice of public accounting in the accounting and auditing function. A reviewer shall be currently active in public practice at a supervisory level in the accounting and auditing function of a member firm, for example (1) as a sole practitioner, (2) as a partner or manager or in an equivalent supervisory position

with a member firm, or (3) in an equivalent supervisory position with a professional corporation. A team captain shall be either a sole practitioner, a partner, or a shareholder of a professional corporation which is a member of PCPS and that has had a peer review and its most recent committee accepted peer review report is unqualified. In addition, a team captain must have attended a training course using AICPA materials conducted in 1986 or later. Effective with reviews beginning on or after April 1, 1994, team captains must have completed eight hours of continuing professional education on performing peer and quality reviews using relevant AICPA materials within five years preceding commencement of a review.

- .28 An individual who serves as team captain for two successive reviews of the same firm may not serve in that capacity for the firm's next peer review.
- .29 In situations where required by the nature of the reviewed firm's practice, individuals (consultants) who need not be CPAs but who have expertise in specialized areas may assist the review team. For example, computer specialists, statistical sampling specialists, actuaries, or educators expert in continuing professional education may participate in certain segments of the review.

Qualifications for Service as a Reviewing Firm

- .30 When a member firm is requested to perform a peer review, the criteria discussed in PCPS §2000.31-.34 should be considered by the firm in determining its capability to perform the peer review prior to accepting the engagement.⁹ Individuals selected by the member firm to participate as review team members should possess the requisite qualifications for reviewers or consultants.
- .31 To conduct a review of a firm that is a member of only the private companies practice section, the reviewing firm must be a member of the PCPS.
- .32 The reviewing firm should have had a peer review and its most recent committee-accepted peer review report should have been unqualified. A reviewing firm that does not meet these requirements must receive the committee's authorization to perform a peer review.

⁹ If the reviewed firm and the firm performing the review are members of the same association, they must adhere to the additional requirements contained in PCPS §3000, "Guidelines for Involvement by Associations of CPA Firms."

Capability

- .33 A reviewing firm must determine its capability to perform a peer review. The reviewing firm must have available to it reviewers with experience in appropriate areas to perform the 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.
- .34 In determining its capability to perform the review, the reviewing firm should consider the size of the firm to be reviewed in relation to its own size. A reviewing firm must also recognize that the performance of a peer review may demand a substantial time commitment, especially from its supervisory personnel. Therefore, a firm should consider carefully the number and availability of supervisory personnel in determining whether it is capable of performing a peer review of another firm.

Correspondent firms

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

The Review**General considerations**

- .37 The review should include the following procedures:
- a. Study and evaluation of the reviewed firm's quality control system
 - b. Review for compliance with the reviewed firm's quality control system at each organizational or functional level within the firm

- c. Review of selected engagements, including the relevant working paper files and reports
 - d. Review for compliance with the section's membership requirements
 - e. Preparation of a written report on the results of the review and, if applicable, a letter of comments
- .38 For a multi-office firm, the review should include visits to the firm's executive office and, if applicable, selected practice offices. A sole practitioner and the reviewer may elect to conduct the review at the reviewer's office or another agreed-upon location subject to the sole practitioner meeting specified criteria as defined in Appendix D, PCPS §2000.131.

Prereview documentation

- .39 Prior to the beginning of a committee-appointed review, the parties must formally document the terms and conditions of the engagement. (See Appendix A, PCPS §5000.51, for an illustrative sample of an engagement letter.) For all other reviews, the parties may wish to formally document the terms and conditions of the engagement.

Scope of the review

- .40 The scope of the review should cover a firm's accounting and auditing practice.¹⁰ Other segments of a firm's practice, such as tax services or management advisory services, are not encompassed by the scope of the review except to the extent (1) they are associated with financial statements or (2) they relate to compliance with the membership requirements of the section. For example, reviews of tax provisions and accruals contained in financial statements are included in the scope of the review. Review team members will not have contact with or access to any client of the reviewed firm in connection with the review.
- .41 The review will be directed to the professional aspects of the reviewed firm's accounting and auditing practice; it will not include the business aspects of that practice. It may be

¹⁰ In the review of federally insured depository institutions with \$500 million or more in total assets, the independent auditor reports on internal control and compliance with laws and regulations. The peer review standards contemplate that such reports issued in connection with a financial statement audit will be included in the scope of the peer review if the audit is selected for review.

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 might consider budgeted and actual time spent on the engagement by various categories or classifications of personnel but would not inquire about fees billed to the client or the relationship of fees billed to time accumulated at usual or standard billing rates.

- .42 Further, when reviewing policies and procedures for advancement, review team members would concern themselves with whether professional personnel were promoted on the basis of demonstrated competence and whether criteria for admission of individuals to the firm give appropriate weight to professional qualifications, but they would not review compensation of professional personnel.
- .43 The review should cover a current period of one year to be mutually agreed upon by the reviewed firm and the team captain. 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/or new professional standards or membership requirements. The scope of the review should encompass the quality control policies and procedures in effect and compliance therewith for the year under review.
- .44 The review team should obtain the reviewed firm's latest peer review or quality review report and, if applicable, its letter of comments and response thereto from the firm or from the AICPA, and the team should consider whether matters discussed therein require additional emphasis in the current review. In all cases, the review team should evaluate the actions taken by the firm in response to the prior report and letter of comments.

Restriction of scope

- .45 When the reviewed firm has had a significant acquisition of another practice or a portion thereof, or a divestment of a significant portion of its practice, during or subsequent to its peer review year, the peer reviewer and/or the reviewed firm should consult with the committee before the review begins to consider the appropriate scope of the review or other actions that should be taken so that the peer review report will not have to be modified for a scope limitation.
- .46 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 of the reasonableness of the explanation; however, 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 the review team concludes that the engagements so excluded do not materially affect the review coverage, then the review team ordinarily would conclude that the scope of the review had not been unduly restricted. In order to reach such a conclusion, the review team should review other engagements in a similar area of practice and review other work of supervisory personnel who participated in the excluded engagements.

Reviews of multi-office firms

- .47 The reviews of engagements should usually be directed toward the accounting and auditing work performed by the practice offices visited and not toward a review of work performed by all of the reviewed firm's practice offices 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.
- .48 For those situations in which engagements selected in the practice office reviewed include the 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 team, however, should evaluate the appropriateness of the instructions for the engagement issued by the reviewed office to another office of the firm, correspondent, or affiliate. The scope of 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 through review of work performed by other offices, correspondents, or affiliates.
- .49 There may be situations when information available to the review team is insufficient for an evaluation of 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, which may be accomplished by forwarding the information to the reviewed office.

Background information

- .50 The review team should obtain background information from the reviewed firm, some of which will have been obtained before the engagement was accepted, including information available from the reviewed firm's application and/or from reports filed with the section. The information should be used 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. (See PCPS §2000.132, Appendix E, "Interpretation: Planning the Scope of a Peer Review.") The statistical information may be stated in terms of approximate amounts or estimates. The following are examples of background information that may be obtained from the firm to be reviewed:
- a. Description of the firm's organization (an organization chart may be useful).
 - b. Firm philosophy, including matters such as—
 1. Firm goals or objectives.
 2. Operating practices regarding service to clients and development of personnel.
 3. Policies relating to industry specialization or practice specialists.
 4. Operating autonomy of practice offices (the extent of decentralization of authority).
 - c. Firm profile. (If the reviewed firm is a multi-office firm, the information should be broken out by individual practice office. Offices that are part of a larger practice unit may be grouped together.)
 1. 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.)
 2. Number of professional accounting and auditing personnel, analyzed by level.
 3. Number of accounting and auditing clients, classified by audits, reviews, and compilations and by type—privately held, governmental, or not-for-profit.

4. Firm management-level personnel, analyzed by years with the firm and areas of experience.
5. Industry concentrations and specialty practice areas, such as regulated industries.
6. Extent of use of correspondent firms on engagements.
7. Extent of international practice.
8. Description of recent mergers.
9. Newly opened offices.

.51 PARAGRAPH DELETED

Study and evaluation of the quality control system

- .52 The review team should commence its review by a study and evaluation of the reviewed firm's quality control system.¹¹ The objective of the study is to evaluate whether the quality control policies and procedures that constitute the reviewed firm's quality control system are designed to accomplish the objectives of quality control standards established by the AICPA to the extent that such objectives are applicable to its practice. This initial evaluation must be continuously re-evaluated by the review team during the review and modified if warranted by the results of its other procedures.
- .53 The reviewed firm's quality control policies and procedures should be considered in relation to (1) the guidance material contained in Quality Control Policies and Procedures for CPA Firms (Appendix C, PCPS §10,000) and (2) the membership requirements of the section. This process assists the review team in evaluating whether the reviewed firm has 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, and has complied with each of the applicable membership requirements of the section.

Study and evaluation of the inspection program

- .54 The standards for performing and reporting on peer reviews provide that a peer review must include a review of compliance

¹¹ Programs and instructions are included in the Peer Review Manual and should be considered for their applicability.

with the firm's quality control policies and procedures for inspection. This review should include such factors as—

- a. Qualifications of personnel assigned to the inspection program.
 - b. Scope of the inspection program (coverage of functional areas and engagements and the criteria for selection thereof).
 - c. Comprehensiveness of the review of the functional areas.
 - d. Depth of the review of individual engagements, particularly with respect to review of working papers and performance in key areas.
 - e. Findings of the inspection program, including a comparison with the peer review findings.
 - f. Nature and extent of reporting.
 - g. Follow-up of inspection findings.
- .55 If the findings of the current inspection program differ in one or more significant respects from the peer review findings, the review team must satisfy itself about the causes and validity of such differences as part of its evaluation of the firm's inspection program. In addition, the review team should consider the inspection findings when forming the conclusions expressed in its report and in developing its letter of comments.
- .56 If the review team initially concludes that it may be able to rely on the reviewed firm's inspection program to reduce the number of offices or engagements or the extent of the functional areas otherwise required to be reviewed, it should test some of the findings and conclusions of the firm's current inspection program. These tests may be accomplished by comparison of the findings of the review team with those of the firm's inspection teams, direct observation of the inspection procedures in selected offices, follow-up review of one or more offices previously visited by the firm's inspection teams, or a combination of such procedures. After evaluating the results of these tests, the review team should decide whether it can reduce the number of offices or engagements or the extent of the functional areas otherwise required to be reviewed.

Extent of compliance tests

- .57 Based on its study and evaluation of the reviewed firm's quality control system, the review team should develop programs to test compliance.¹² The compliance tests should be tailored to the practice of the firm under review and 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. Such compliance tests should be performed at the practice offices selected for review, on a firm-wide and on an individual engagement basis. These tests may include—
- a. Inquiries of persons responsible for a function or activity.
 - b. Review of selected administrative and personnel files.
 - c. Interviews with firm professional personnel at various levels.
 - d. Review of selected engagements, including relevant working paper files and reports.
 - e. Review of other evidential matter.

Location of documentation

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

Selection of offices

- .59 The process of office selection is not subject to definitive criteria and requires the exercise of judgment. Visits to practice offices should be sufficient to enable the review

¹² Instructions, checklists, and programs are included in the Peer Review Manual and should be considered for their applicability.

team to evaluate whether the reviewed firm's quality control policies and procedures (including their application to work performed for another office of the reviewed firm, for a correspondent firm, or for an affiliated firm) are adequately communicated to professional personnel and whether they are being complied with.

- .60 A review team should select at least one of the larger offices and one to three others in a multi-office firm with fifteen or fewer offices and 15 to 25 percent of the offices in a firm with more than fifteen offices. However, the review team may depart from these guidelines if its evaluation of the scope and results of the reviewed firm's inspection program and its consideration of other pertinent factors justify such departure. If an inspection was not performed in the prior year, the review team should consider exceeding these guidelines.¹³
- .61 The practice offices selected should provide a reasonable cross section of the reviewed firm's accounting and auditing practice. Accordingly, the office selection process should include consideration of the following factors:
- a. Number, size, and geographic distribution of offices
 - b. The review team's evaluation of the firm's inspection program and the extent to which the review team might rely on the current year's inspection in determining the number and location of offices to be visited and reviewed by the review team
 - c. The degree of centralization of accounting and auditing practice control and supervision
 - 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 regulated industries, to the firm and to individual offices

¹³ In such circumstances, a firm should ordinarily receive a modified report for failure to have performed adequate inspection procedures if the other findings on the review are significant and should have been detected if the firm had performed adequate inspection procedures. (See PCPS §10,000, Appendix B, "Interpretation of Quality Control Standards," Footnote 1.)

Selection of engagements

- .62 The number and type of accounting and auditing engagements reviewed, when combined with the performance of other procedures, 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 complied with during the year under review.
- .63 Client engagements subject to selection for review ordinarily should be those with years ending during the period under review unless a more recent report has been issued at the time the review team reviews engagements. The number of engagements to be selected and the percentage of the firm's accounting and auditing hours to be reviewed will be affected by the size and nature of the firm's practice. The review team's evaluation of the firm's inspection program also affects the number of engagements to be selected for review and the percentage of the firm's accounting and auditing hours to be reviewed.
- .64 The review team generally should select 5 to 10 percent of the accounting and auditing hours of a firm with 15 or fewer offices and 3 to 6 percent of such hours in a firm with more than 15 offices. However, the review team may depart from these guidelines, if its evaluation of the scope and results of the reviewed firm's inspection program and its consideration of other pertinent factors justify such departure. If an inspection was not performed in the prior year, the review team should consider exceeding these guidelines.
- .65 Engagements selected for review should provide a reasonable cross section of the reviewed firm's accounting and auditing practice, considering concentrations of engagements in specialized industries. If the review team believes that the engagements selected for review do not provide a reasonable cross section of the firm's accounting and auditing practice due to the specific engagement criteria set forth in this section, the review team should consider consulting with the committee. In view of the special considerations involved, greater weight should be given to selecting engagement in which there is a significant public interest (such as publicly held clients, financial and lending institutions, and brokers and dealers in securities), and to selecting engagements that are large, complex, or high risk or that are the reviewed firm's initial audits of clients. (See PCPS §2000.130, Appendix C, "Selecting Engagements for Review.") In addition, the sample of engagements selected for review should include:

- a. One or more audits conducted pursuant to the Government Auditing Standards issued by the U.S. General Accounting Office (the "Yellow Book")
 - b. One or more audits conducted pursuant to the Employee Retirement Income Security Act of 1974 (ERISA)
 - c. One or more audits subject to Section 36 of the Federal Deposit Insurance Act.
- .66 The engagements selected should include an adequate sample of work performed by practice offices visited for other offices of the reviewed firm so that the application of the firm's specific quality control policies and procedures for such work can be appropriately tested.
- .67 In order to make its selection of engagements, the review team should obtain information such as a list of the firm's clients, the types of industries, the types of clients (for example, publicly held, privately held, governmental, or not-for-profit), client size (for example, revenues and assets), the types of engagements (for example, audit, review, or compilation), the number of engagement hours, and the names of the partners and supervisory personnel associated with the engagements.
- .68 The time required to review selected individual engagements will vary depending on the size, nature, and complexity of the engagement. Review time for smaller engagements generally may be expected to be proportionately greater than that required for larger engagements in relation to total hours for those engagements.

Extent of engagement review

- .69 The objectives of the review of engagements are to obtain evidence of (1) whether 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 to the extent that such objectives are applicable to its practice, and (2) whether the reviewed firm complied with the policies and procedures that constitute its system of quality control during the year under review. 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 reviewers' judgment; however, the review ordinarily should include all key areas of an engagement to determine whether well planned, appropriately executed, and suitably

documented procedures were performed on the engagement in accordance with the reviewed firm's quality control policies and procedures.

- .70 For each engagement reviewed, the review team must document, based on its review of the engagement working papers and representations from reviewed firm personnel, whether anything came to the review team's attention that caused it to believe that (1) the financial statements were not presented in all material respects in accordance with generally accepted accounting principles, (2) the firm did not have a reasonable basis under the applicable professional standards for the report issued, (3) the documentation on the engagement did not support the report issued, or (4) the firm did not comply with its quality control policies and procedures in all material respects.¹⁴
- .71 In performing engagement reviews, the review team may encounter (a) indications of significant failures by the reviewed firm to reach appropriate conclusions in the application of professional standards, which include generally accepted auditing standards, standards for accounting and review services, and generally accepted accounting principles (for example, the reviewed firm may have issued an inappropriate report on a client's financial statements or omitted a necessary auditing procedure), or (b) situations in which the documentation on the engagement does not appear to support the report issued. In either case, the team captain shall promptly inform an appropriate authority within the reviewed firm (generally on a "Matter for Further Consideration" form). In such circumstances, it is the responsibility of the reviewed firm to investigate the matter questioned by the review team and determine what action, if any, should be taken.¹⁵
- .72 The reviewed firm should advise the review team of the results of its investigation and document its actions taken or planned or its reasons for concluding that no action is required.
- .73 If the reviewed firm believes after investigating the matter that it can continue to support its previously issued report,

¹⁴ See the conclusion section of the engagement checklists contained in the Peer Review Manual.

¹⁵ The reviewed firm is required under generally accepted auditing standards to take appropriate action under certain circumstances with respect to (1) subsequently discovered information that relates to a previously issued report or (2) the omission of one or more auditing procedures considered necessary to support a previously expressed opinion (AICPA Profession Standards, vol. 1, AU sections 561 and 390).

it should provide the review team with written representations to that effect (generally on a "Matter for Further Consideration" form). If the representations are reasonable, the review team should conclude that the provisions of the AICPA Professional Standards, vol. 1, AU sections 390 and 561 do not apply; however, the review team should consider whether the documentation on the engagement supports the report issued.¹⁶ In evaluating the representations, the review team should recognize that it has not made an examination of the financial statements in accordance with generally accepted auditing standards (or reviewed or compiled them in accordance with the standards for accounting and review services), nor does it have the benefit of access to client records, discussions with the client, or specific knowledge of the client's business.

- .74 If, after receiving the results of the reviewed firm's investigation, the review team continues to believe that there may be a significant failure to reach appropriate conclusions in the application of professional standards, it should pursue any remaining questions with the reviewed firm.
- .75 If the team captain believes that the actions taken by the reviewed firm do not meet the requirements of professional standards, the team captain should report the matter to the committee promptly.
- .76 If a majority of the committee members eligible to vote on matters related to that peer review disagree with the position of the reviewed firm and the reviewed firm still does not change its position, the reviewed firm shall agree (1) to refer the matter promptly to the AICPA professional ethics division in a form acceptable to the committee, and (2) to advise the committee of the actions taken by the firm as a result thereof within thirty days of receipt of notification of the conclusions of the AICPA professional ethics division on the matter.

Expansion of scope

- .77 If, during the course of the peer review, the review team concludes that there was a significant failure by the reviewed firm to reach an appropriate conclusion on the application of professional standards on an engagement, the review team should consider whether the application of additional review procedures is necessary.¹⁷ This consideration should be documented in the peer review working papers. The objective of

¹⁶ See PCPS §2000.89-.99 for reporting considerations.

¹⁷ See PCPS §2000.69-.76 for action(s) required regarding the specific engagement involved.

the application of additional procedures would be to determine whether the significant failure is indicative of a pattern of such failures and/or of a significant weakness in the reviewed firm's system of quality control or in compliance with the system. Under some circumstances, the reviewer may conclude that, because of compensating controls, or for other reasons, further procedures are unnecessary. If, however, additional procedures are deemed necessary, they may include an expansion of scope to review all or relevant portions of one or more additional engagements. Such additional engagements may be in the same industry, or supervised by the same individual in the reviewed firm, or otherwise have characteristics associated with the failure to apply professional standards.

Completion of the Review

- .78 Prior to issuing its report and, if applicable, letter of comments, the review team must communicate its conclusions to the reviewed firm. This communication ordinarily would take place at a meeting (exit conference) attended by appropriate representatives of the review team and the reviewed firm. It is normally expected that the managing partner and the partners having firm-wide responsibility for quality control and accounting and auditing will attend this meeting. The review team should notify the AICPA quality review division staff of the date and time of the scheduled exit conference to permit committee representatives to attend the exit conference, if they so elect. The parties should discuss the report and letter of comments, if any, to be issued as well as any suggestions for improvement. Accordingly, the review team, except in rare instances, should not hold the exit conference until the results of the peer review have been summarized and the report and letter of comments, if any, have been drafted or a detailed outline has been prepared of the matters to be included in these documents. If there is uncertainty about the opinion to be expressed, the review team should postpone the exit conference until a decision has been reached. When discussing its findings, recommendations, and suggestions at the conference, the review team should give an in-depth explanation of each matter or suggestion.
- .79 For the review of a multi-office firm, the review team for a practice office should, in addition to the communication described in the preceding paragraph, communicate the findings of its review to appropriate individuals at the offices reviewed.

Review Team Working Papers

- .80 Working papers must be prepared by the review team to document the work performed and the findings and conclusions of the review team. To facilitate summarization of the review team's findings and conclusions, the team captain should instruct the review team concerning the manner in which working papers, including programs and checklists, are to be prepared. Working papers and engagement review checklists should not identify the reviewed firm's clients.
- .81 During the course of the peer review, the review team should continually evaluate the firm's system of quality control and its compliance therewith. "Matter for Further Consideration" (MFC) forms should be prepared for matters that could indicate that one or more of the applicable objectives of quality control standards were not accomplished by the reviewed firm's policies or procedures, or that the reviewed firm did not comply with professional standards, the policies and procedures that constitute its quality control system, or a membership requirement. Reviewers should conclude on the implications for the system of the matters identified on the MFCs and indicate their disposition. (The factors the review team should consider in evaluating the instances of noncompliance and deficiencies in the design of the firm's quality control system are described more fully under "Reporting Considerations," PCPS §2000.89-.99, and "Letter of Comments," PCPS §2000.100-.105.)
- .82 At the conclusion of field work, the reviewers should do the following: (a) summarize all of their findings (including answers to the individual engagement checklists and MFCs); (b) evaluate the nature, causes, pattern, pervasiveness, and significance of the deficiencies noted in the design of the firm's quality control system and in the firm's compliance with its system, with professional standards, and with the membership requirements of the section; and (c) consider whether such matters should result in a qualified report, be included in the letter of comments, or otherwise be communicated to the firm. The summary also assists the team captain in the preparation of an overall summary review memorandum. Such a memorandum should cover (a) the planning of the review, (b) the scope of work performed, and (c) the findings and conclusions to support the report and the letter of comments issued. It should also include comments communicated to senior management of the reviewed firm that were not deemed of sufficient significance to be included in the letter of comments. In a review of a multi-office firm, similar procedures would be followed for each office reviewed.
- .83 All working papers, reports, and letters prepared during a PCPS peer review should be retained after the report has been

issued only for the period of time specified by the committee to permit oversight of this part of the review process.¹⁸ The committee may extend this period on individual reviews when it believes that it may need to refer to such working papers to carry out its responsibilities.

Reporting on Peer Reviews

The Review Team's Report

- .84 Within thirty days of the date of the exit conference, the review team should furnish the reviewed firm with a written report and, if applicable, a letter of comments.
- .85 The report and letter should be addressed to the proprietor, partners, or stockholders/officers of the reviewed firm and should be dated as of the date of the exit conference. A report by a review team from a member firm should be issued on the reviewing firm's letterhead and signed in the firm's name. All other reports should be on the letterhead of the entity that appointed or formed the review team and signed by the team captain on behalf of the review team, without reference to the captain's firm.
- .86 The team captain should notify the section that the review has been completed and the report and letter have been issued. If no letter was issued, the notification should so state.
- .87 The reviewed firm should submit a copy of the report, the letter, and its response thereto to the section within thirty days of the date the report and letter of comments were issued.¹⁹
- .88 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 committee has accepted the report.

Reporting Considerations

- .89 The report should contain:

¹⁸ See "Retention Period" under "Review Team Working Papers" in PCPS §5000.26-.29, "Administrative Procedures of the Peer Review Program."

¹⁹ See Appendix C, PCPS §1000.39, regarding the actions that will be taken when a review team or a reviewed firm does not carry out its responsibilities on a timely basis.

- a. A statement of the scope of the review
 - b. A description of the general characteristics of a system of quality control
 - c. A reference to the letter of comments, if the report was modified or adverse
 - d. The review team's opinion on whether the reviewed firm's quality control system met the objectives of quality control standards established by the AICPA, and whether it was being complied with to provide the firm with reasonable assurance of conforming with professional standards—and if not, a description of the reasons for the qualification
 - e. The review team's 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
- .90 A review team may issue an unqualified or a qualified report.²⁰ (See PCPS §2100, "Guidelines for and Illustrations of Peer Review Reports.") In deciding on the type of report to be issued, a review team should consider the evidence it has obtained and form three overall conclusions with respect to the year being reviewed—
- a. Whether the policies and procedures that constitute the reviewed firm's system of quality control for its accounting and auditing practice met the applicable objectives of quality control standards established by the AICPA to the extent required to provide the firm with reasonable assurance of conforming with professional standards. (See Appendix A, "Statement on Quality Control Standards 1," and C, "Quality Control Policies and Procedures for CPA Firms: Establishing Quality Control Policies and Procedures," PCPS §10,000.)
 - b. Whether personnel of the reviewed firm complied with such policies and procedures in order to provide the firm with reasonable assurance of conforming with professional standards.
 - c. Whether the reviewed firm complied with the membership requirements of the section in all material respects.

²⁰ In this section, the term qualified report includes a modified or an adverse opinion.

- .91 In order to give appropriate consideration to the evidence obtained and to form the 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.

Design deficiencies

- .92 Use of professional judgment is especially essential in formulating the first conclusion described above. In forming this conclusion, the review team should consider the significance of any design deficiencies noted in the reviewed firm's system of quality control. A design deficiency exists when the reviewed firm's quality control policies and procedures, even if fully complied with, are not likely to accomplish an applicable quality control objective.
- .93 The significance of design deficiencies noted in the quality control policies and procedures, individually and in the aggregate, should be evaluated in the context of the reviewed firm's organizational structure and the nature of its practice. An apparent deficiency in certain quality control policies and procedures may be partially or wholly offset by other policies or procedures. Therefore, the review team should consider the interrelationships among the elements of quality control and weigh apparent deficiencies against compensating policies and procedures.
- .94 Deficiencies in the design of a system of quality control would be significant, and a qualified report should be issued, if the design of the system resulted in one or more quality control objectives not being accomplished and, as a result, a condition was created in which a firm did not have reasonable assurance of conforming with professional standards in its accounting and auditing practice during the year being reviewed. For example, a failure to establish appropriate procedures for reviewing accountants' reports and accompanying financial statements may result in engagements that do not meet the requirements of professional standards.
- .95 In forming a conclusion about the design of the quality control system, a review team should consider the implications of the evidence obtained during its study and evaluation of the quality control system and its tests of compliance, including its review of engagements. Thus, the review team should consider whether failures to comply or document compliance with professional standards, particularly failures requiring application of the AICPA Professional Standards, vol. 1, AU sections 390 and 561, are indicative of significant design

deficiencies in the reviewed firm's quality control policies and procedures. On the other hand, a review team may conclude that a significant design deficiency exists even though it did not result in any deficiencies on the engagements reviewed.

Noncompliance with quality control policies and procedures

- .96 The degree of compliance by the personnel of the reviewed firm with its prescribed quality control policies and procedures should be adequate to provide the reviewed firm with reasonable assurance of conforming with professional standards on accounting and auditing engagements. Because variance in individual performance and professional interpretation will affect the degree of compliance, adherence to all policies and procedures in every case may not be possible.
- .97 In assessing whether the degree of compliance was adequate to provide the required assurance, the review team should consider the nature, causes, pattern, and pervasiveness of the instances of noncompliance noted, and their implications for the firm's quality control system as a whole, not merely their importance in the specific circumstances in which they were observed. In order to do this, the review team should evaluate the instances of noncompliance, both individually and collectively, recognizing that adherence to certain policies or procedures of the reviewed firm was more critical to that firm's obtaining reasonable assurance of meeting professional standards than adherence to others. In this connection, the review team should consider the likelihood that noncompliance with a given quality control policy or procedure could have resulted in engagements not being performed in conformity with professional standards. The more direct the relationship between a specific quality control policy or procedure and the application of professional standards, the higher the degree of compliance should have been to warrant the issuance of an unqualified report.
- .98 If a review team concludes that the nature, causes, pattern, pervasiveness or implications of instances of noncompliance are of such significance, individually or in the aggregate, that the reviewed firm's degree of compliance with its prescribed quality control policies and procedures did not provide it with reasonable assurance of conforming with professional standards, a qualified report should be issued. In addition, when the nature and degree of noncompliance at one or more offices of a multi-office firm were of such significance that the office did not have reasonable assurance of conforming with professional standards, the review team should consider whether a qualified report should be issued, even though the degree of compliance for the remainder of the firm

provided the firm as a whole with reasonable assurance of conforming with professional standards.²¹

Noncompliance with membership requirements

- .99 The review team should evaluate whether the reviewed firm complied in all material respects with each of the membership requirements of the section. While 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 instances 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 usually are more critical.

Letter of Comments

- .100 The review team ordinarily will issue a letter of comments (letter) concurrently with its report. The major objectives of the letter are to report matters, including the matters, if any, that resulted in a qualified report, 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, and, if appropriate, to set forth recommendations regarding those matters.²²

Contents of the letter

- .101 The letter should be addressed, dated, and signed in the same manner as the report. It should include—
- a. A reference to the report indicating if it was modified or adverse.
 - b. A description of the purpose of the peer review.

²¹ If the review team concludes that these matters are not of such significance to warrant a qualified report, the review team should consider whether the matters should be included in the letter of comments. (See "Letter of Comments," PCPS §2000.100-.105.)

²² "Remote" has the same meaning in these standards as in Statement of Financial Accounting Standards No. 5, paragraph 3c (that is, the chances are slight that the reviewed firm would not conform with professional standards on accounting and auditing engagements).

- c. A statement that the review was performed in accordance with standards promulgated by the section.
 - d. A description of the limitations of a system of quality control.
 - e. The reviewer's findings.
 - f. A statement that the matters discussed in the letter were considered in determining the opinion on the system of quality control.
- .102 If any of the matters to be included in the letter were included in the letter issued in connection with the firm's previous peer review or quality review, that fact ordinarily should be noted in the description of the matter. In addition, although not required, the review team may indicate how corrective action might be implemented. The letter may also include comments concerning actions taken, in process, or to be taken by the reviewed firm.
- .103 PCPS §2200, "Guidelines for and Illustrations of the Letter of Comments," illustrates how the foregoing matters may be covered in a letter of comments.

Matters to be included in the letter of comments

- .104 If a qualified peer review report is issued, the accompanying letter of comments must include a section on the matters that resulted in the qualification. This section would ordinarily include an elaboration of the findings discussed in the qualifying paragraph of the report.
- .105 In addition to any matters that resulted in a qualified report, the letter should include other appropriate comments, as discussed below, regarding the design of the reviewed firm's system of quality control, or its compliance with that system (including professional standards), or with the membership requirements of the section.
- a. Comments regarding the design of the firms quality control policies and procedures—Deficiencies in the design of the reviewed firm's system of quality control should be included in the letter if the design of the system resulted in one or more quality control objectives not being accomplished and as a result a condition was created in which there was more than a remote possibility that the firm would not conform with professional standards on accounting and auditing engagements, even though the firm had reasonable assurance of conforming with professional standards. The letter should include comments on such

deficiencies 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 such design deficiencies, the presence of the engagement deficiencies ordinarily should be noted in the comment along with the description of the design deficiency.²³

- b. Noncompliance with the firm's system of quality control— Instances of noncompliance with significant firm policies or procedures should be included in the letter whenever the degree of such noncompliance created a condition in which there was more than a remote possibility that the firm would not conform with professional standards on accounting and auditing engagements, even though the degree of noncompliance was not such as to warrant a qualified report. (See also the discussion on "noncompliance" covered in PCPS §2000.96-.98.)
1. In assessing whether the degree of noncompliance created such a condition, the review team should consider the nature, causes, pattern, and pervasiveness of the instances of noncompliance noted, as well as the implications for the firm's quality control system as a whole, not merely the importance in the specific circumstances in which the instances were observed. In order to do this, the review team should evaluate the instances of non compliance, both individually and collectively, recognizing that adherence to certain policies or procedures is more critical to assuring conformity with professional standards than is adherence to others. Accordingly, a higher degree of compliance should be expected for the more critical policies and procedures. However, noncompliance with quality control policies and procedures that are less critical to assuring conformity with professional standards may also be reportable in a letter of comments; for example, failures to comply with the firm's hiring or advancement policies could create a condition in which there was more than a remote possibility that the firm would not conform with professional standards on accounting and auditing engagements, either currently

²³ "Nonconformity with professional standards" refers to those situations where the review team concluded that the reviewed firm should consider taking action pursuant to the AICPA Professional Standards vol. 1, AU sections 390 or 561 or where the review team concluded that the firm lacked a reasonable basis under the standards for accounting and review services for the report issued.

or in the future. When engagement deficiencies, particularly instances of nonconformity with professional standards, were attributable to the instances of noncompliance with significant firm policies or procedures that are included in the letter, the review team ordinarily should include that information in the comment along with the description of the instances of noncompliance with the significant firm policy or procedure.

2. When the nature and degree of noncompliance at one or more offices of a multi-office firm were of such significance that a condition was created in which there was more than a remote possibility that the office would not conform with professional standards on accounting and auditing engagements, the review team should consider whether the matter should be included in the letter of comments, even though the degree of compliance for the remainder of the firm did not create such a condition with respect to the firm as a whole.
 3. While isolated instances of noncompliance ordinarily would not be included in a letter, 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.
- c. Noncompliance with membership requirements—The review team should evaluate whether the firm complied in all material respects with each of the membership requirements of the section. When the firm had not achieved a very high degree of compliance with membership requirements of the section, that fact should ordinarily be included in the letter. In evaluating the significance of instances 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 usually are more critical.

Letter of Response

- .106 The reviewed firm is required to respond in writing to the review team's comments on matters in the letter of comments. The response should be addressed to the committee and should individually describe the actions taken or planned with respect to each matter in the letter. If the reviewed firm disagrees with one or more of the comments; its response should describe the reasons for such disagreement.

- .107 PCPS §2300, "Suggestions for Writing a Response to a Letter of Comments," illustrates how a firm may respond to a letter of comments.

Letter of Suggestions

- .108 During most reviews, the review team will note policies and/or procedures that, if adopted or changed by the reviewed firm, would enhance its practice. These matters might include (1) instances of noncompliance with the reviewed firm's quality control policies or procedures that do not create a condition in which there is more than a remote possibility that the reviewed firm will not conform with professional standards, or (2) suggestions concerning efficiency or economy. Suggestions regarding these matters may be communicated orally or in a letter of suggestions. If a letter of suggestions is prepared, it should not be prepared on AICPA letterhead or included in the review team's working papers since it is a communication between the team captain and the reviewed firm only.

Engagements Suspended or Terminated Prior to Completion

- .109 A member firm or a reviewer may not terminate its peer review before its completion without the prior approval of the committee chairman or his designee.
- .110 A suspension ordinarily will be approved when the reviewed firm's quality control system has not been operating for at least one year or when significant quality control policies and procedures have not been implemented at the time of the review. However, such approval will be withheld when the review team has noted significant deficiencies related to engagements.
- .111 In the event that a review is suspended or terminated prior to completion, the team captain should advise the reviewed firm and the committee in writing of the date and the substantive reasons for the suspension or termination.

Disagreement Within Review Team

- .112 If a team captain disagrees with a conclusion reached by a team member, the captain must document the reasons for disagreement. An unresolved disagreement regarding the type of report to be issued or matters to be included in the letter of comments should be documented and referred to the committee for resolution.

Disagreement Between Reviewed Firm and Review Team Captain

- .113 In some instances a disagreement may arise between the reviewed firm and the team captain. In such instances the matter should be discussed with the committee's staff, who, if the disagreement cannot be resolved, will refer the matter to the chairman of the committee or a designee.

Committee Consideration of Reports on Peer Reviews

- .114 Reports on peer reviews are to be sent to the committee, together with letters of comments, if any, and responses to those letters by reviewed firms. Upon acceptance by the committee, the report, the letter of comments and the reviewed firm's response thereto will be placed in the public files.
- .115 Prior to acceptance, the staff of the committee reviews all or selected working papers of the review team, evaluates whether the findings are properly reported upon and reports its conclusions to the committee. The committee reviews each report, letter of comments, if any, the reviewed firm's response to it, and the comments of the committee's staff. The committee considers whether—
- a. The review has been performed in accordance with the standards for performing peer reviews.
 - b. The report, letter of comments, and the response thereto are in accordance with the standards for reporting on peer reviews.
 - c. It should take any action concerning matters contained in the letter of comments, including any matters that resulted in a qualified report.
- .116 In reaching its conclusions, the committee will make whatever inquiries or initiate whatever actions it considers necessary in the circumstances. These actions might include one or more of the following:
- a. Obtaining additional information from, or meeting with, the review team or the reviewed firm to achieve a better understanding of the facts and circumstances

- b. Requesting the review team to revise the report or the letter of comments²⁴
 - c. Obtaining additional written assurance from the reviewed firm regarding when and how a matter giving rise to a qualification, if any, or included in the letter of comments will be treated
- .117 If further inquiry or action is initiated, a committee member may be assigned to follow the matter until it is concluded.
- .118 Ordinarily a report is accompanied by a letter of comments. In evaluating the report, letter of comments, and the reviewed firm's response thereto, and after concluding any inquiry or action described above, the committee will consider what additional actions, if any, are necessary on the part of the reviewed firm or the committee in connection with the acceptance of these documents. When additional actions are required, they may include the following:
- a. Obtaining documentary evidence that the matter has been appropriately treated by the reviewed firm
 - b. Requesting the reviewed firm to submit a copy of its next inspection report
 - c. Requesting a reviewer to revisit the firm, at the firm's expense, to evaluate whether appropriate action has been taken
 - d. Requesting the reviewed firm to agree to accelerate the date of its next peer review
 - e. Requesting the reviewed firm to hire a competent party from outside the firm to review reports, accompanying financial statements, and related working papers, and to perform such other functions as the committee or the firm deem appropriate
 - f. Recommending to the executive committee that sanctions be imposed on the reviewed firm

²⁴ The revised peer review documents must be received by the committee's staff within 60 calendar days after the committee meeting at which the review was accepted and the revisions were suggested. If not, the review will not be considered "accepted" and the results of the review will be reconsidered at the committee's next meeting.

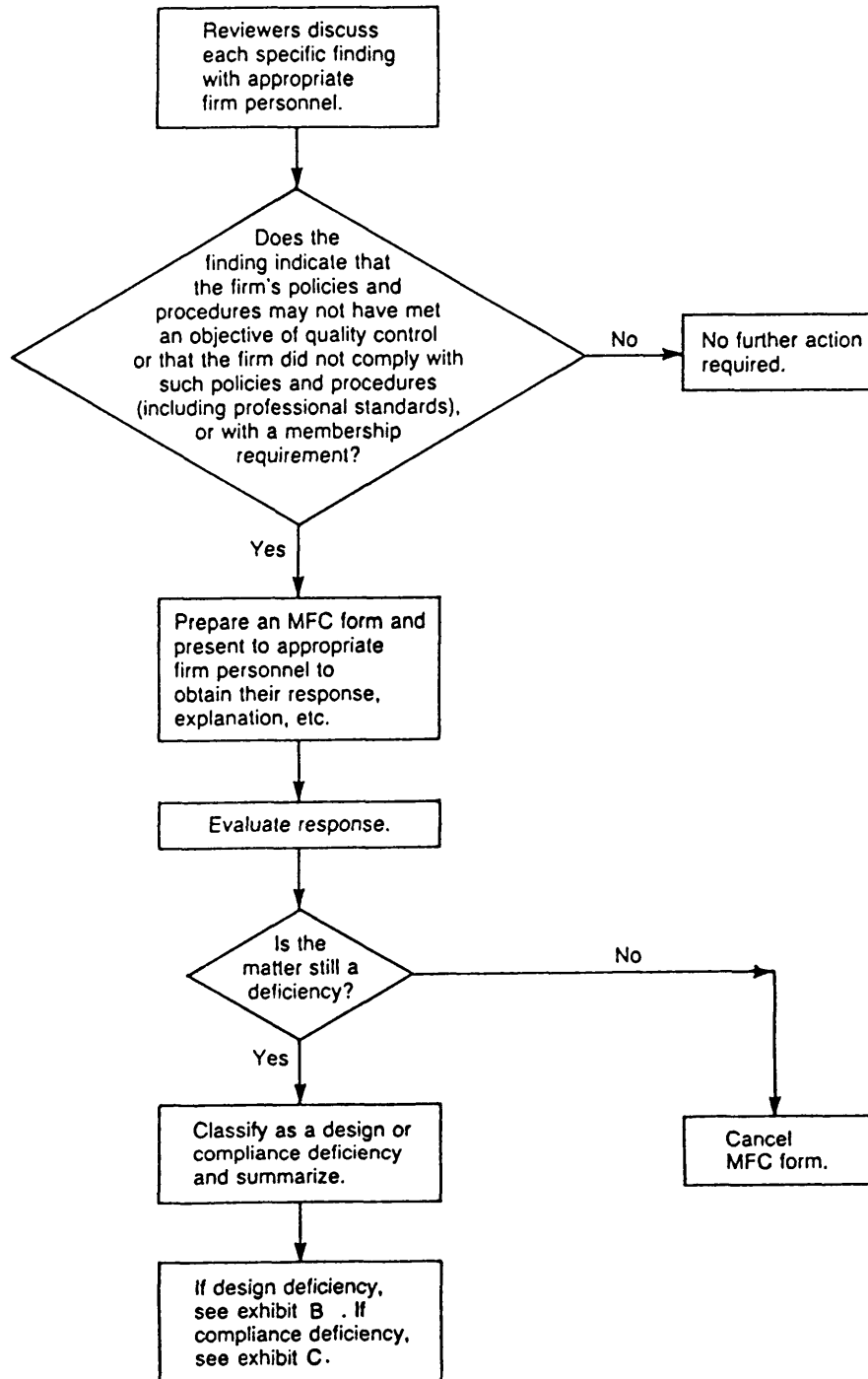
- .119 Several factors influence the committee's decisions. The factors include the committee's judgment regarding—
- a. The nature and significance of the matters in the letter of comments.
 - b. Whether the reviewed firm's response presents either a satisfactory course of action or convinces the committee that additional action is unnecessary.
 - c. Whether the reviewed firm's response to a matter appears to be an arbitrary rejection of the comment or an inappropriate conclusion not to take suitable action.
- .120 If no additional actions are deemed necessary, the report, the letter of comments, and the reviewed firm's response will be placed in the public files. If additional actions are deemed necessary by the committee, the aforementioned documents will be placed in the public file along with a memorandum indicating that it has been accepted with the understanding that the firm will agree to take certain actions. The letter setting forth those actions and the firm's agreement to undertake them will be placed in the public files upon receipt. (See Appendix C, PCPS §1000.39.)
- .121 In unusual circumstances, the committee may deem it appropriate to place a report, letter of comments and the reviewed firm's response thereto, in the public files before they have been accepted. In such circumstances, the public file is supplemented with a memorandum stating that further inquiry has been initiated or describing the actions.

Disagreement Between Committee and Review Team

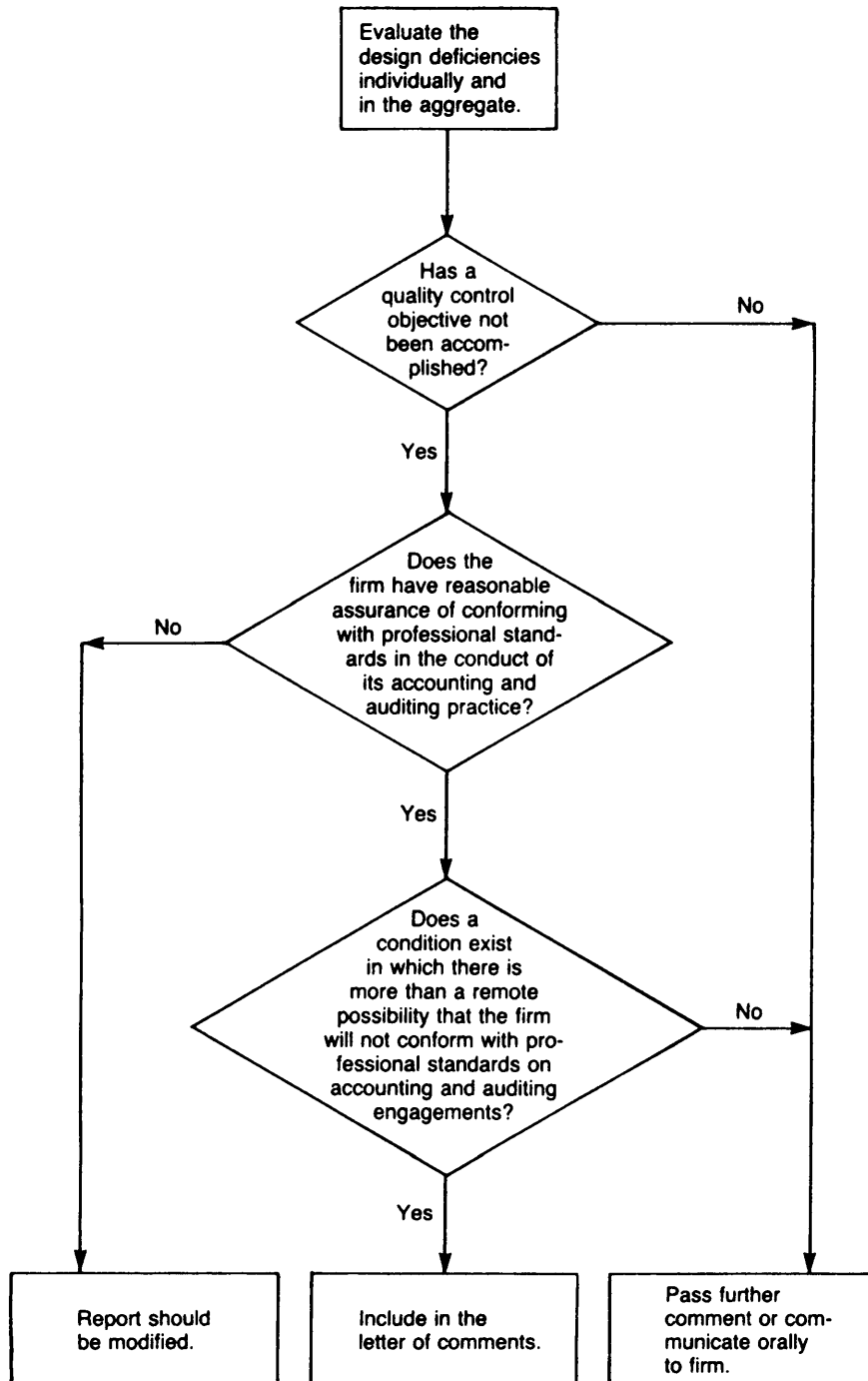
- .122 If, after completing consideration of the report on a peer review and after making such inquiries as deemed appropriate, a majority of the committee members eligible to vote on matters related to that peer review disagree with the report issued by the review team, the review team will be requested to revise its report. If the review team will not revise its report, the committee may refuse to accept the report. Alternatively, the committee may decide to appoint two qualified individuals, at least one of whom will be a committee member, to serve as an evaluation panel. The committee will designate one of the panel members to serve as chairman.
- .123 The purpose of the evaluation panel is to perform sufficient procedures to provide a basis for the panel to issue its own report and, if necessary, letter of comments. Concurrent with the issuance of its report, the evaluation panel will forward its working papers to the committee.

.124 The panel's report and, if applicable, the letter of comments and the reviewed firm's response thereto will be considered for acceptance by the committee. Once accepted, the revised report will be placed in the public files, and the revised letter of comments and the reviewed firm's response will be placed in the public files.

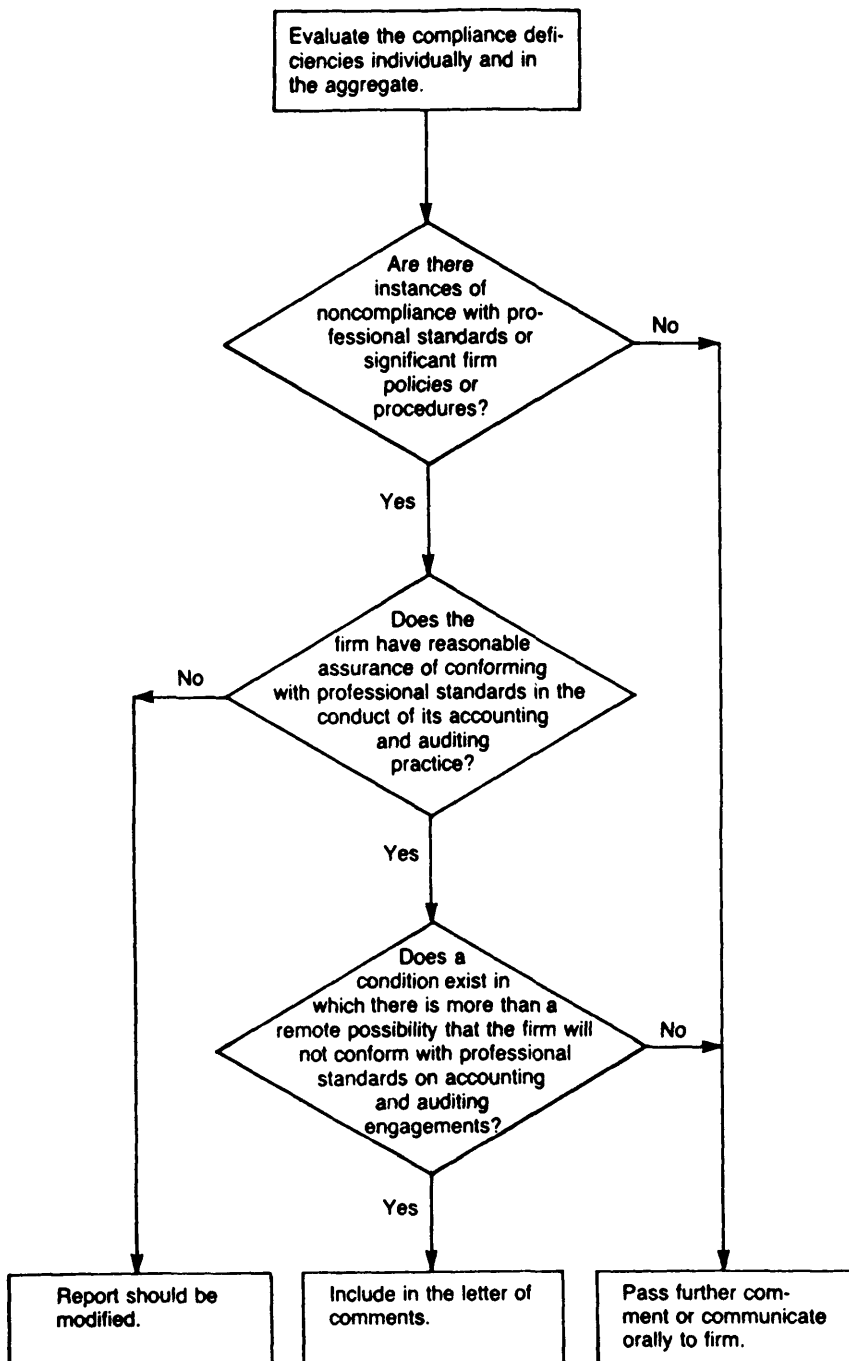
.125 Exhibit A: Reporting Peer Review Findings



.126 Exhibit B: Design Deficiencies



.127 Exhibit C: Compliance Deficiencies (Other Than With a Membership Requirement)



.128 **APPENDIX A—Interpretation: Independence and Conflict of Interest**

1. Services provided by one accounting firm for another do not impair independence or create a conflict of interest provided (a) the fees for such services are not material to either the reviewed firm or the reviewing firm and (b) the services are not an integral part of the reviewed firm's system of quality control other than the inspection function. With respect to (b), providing services that are an integral part of the reviewed firm's system of quality control would not impair independence provided the services are reviewed by an independent party.
2. The independence and conflict-of-interest requirements also apply to committee members and others involved in reviewing working papers prepared in conjunction with a peer review; however, the requirements do not apply to such individuals' firms.

Examples

3. The following examples illustrate how the independence and conflict-of-interest requirements are to be interpreted.

Question 1. Firm A audits the financial statements of Firm B's pension plan. Could either firm perform a peer review of the other?

Answer. Yes, provided that the fees incurred for the audit are not material to either of the firms. An audit of financial statements is a customary service of an accounting firm. However, reciprocal peer reviews are not permitted.

Question 2. Firm A is engaged by Firm B to perform a quality control document review and/or a preliminary quality control procedures review. Could Firm A also perform a peer review of Firm B?

Answer. Yes.

Question 3. A partner in Firm A serves as an expert witness on behalf of Firm B or on behalf of a party opposing Firm B. Are Firms A and B independent of each other?

Answer. Yes, provided that the fee is not material to either firm and provided that the outcome of the matter, if adverse to Firm B, would not have a material effect on its financial condition or its ability to serve clients.

Question 4. Firm A has an arrangement with Firm B whereby Firm A sends its staff to continuing education programs developed by Firm B. Can Firm B perform a peer review of Firm A?

Answer. No, unless Firm B has had its continuing education programs reviewed by an independent party. The independent review should be similar to the review of quality control materials and should meet the same review and reporting standards. (See PCPS §2500, "Review of Quality Control Materials.") If such an independent review is not undertaken and reported on before the peer review commences, Firm B would not be considered independent for purposes of conducting the peer review. However, occasional attendance by representatives of Firm A at programs developed by Firm B would not preclude Firm B from reviewing Firm A.

Question 5. Firm A occasionally consults with Firm B with respect to specific accounting, auditing, or financial reporting matters. Are Firms A and B independent of each other?

Answer. Yes, unless the frequency of the consultation is such that Firm B is an integral part of Firm A's consultation process.

Question 6. On a few of its audit engagements, Firm A retains Firm B to perform a preissuance review of the audit report and accompanying financial statements. Can Firm B perform a peer review of Firm A?

Answer. No, because the appearance of Firm B's independence would be impaired.

Question 7. Firm B uses Firm A's accounting and auditing manual as its primary reference source. Can Firm A perform a peer review of Firm B?

Answer. No, unless Firm A has had its accounting and auditing manual and any other of its reference material used by Firm B as a primary reference source reviewed by an independent party. The independent review of the materials should be similar to the review of quality control materials and should meet the same review and reporting standards. (See PCPS §2400, "Standards for Performing and Reporting on Reviews of Quality Control Materials.") If such an independent review is not undertaken and reported on before the peer review commences, Firm A would not be considered independent for purposes of conducting the peer review. However, if the manual is used only as a part of the firm's overall reference library, independence would not be impaired.

Question 8. Firm A performs a peer review of Firm B. Subsequently, Firm C performs a peer review of Firm B, and Firm D of

Firm A. Would the restriction against reciprocity be violated if Firm B were now to review Firm A?

Answer. No. Although the standards for performing and reporting on peer reviews state that reciprocal reviews are not permitted, that provision is only intended to prohibit back-to-back reviews when each firm has not had an intervening review by another firm or team.

Question 9. A manager from Firm A served as a team member on the most recent peer review of Firm B. Can a professional from Firm B serve on the peer review team of Firm A?

Answer. No, because that would be considered a reciprocal review.

Question 10. Can Firm A be engaged by Firm B to conduct an inspection of Firm B's accounting and auditing practice and subsequently be engaged to perform a peer review of Firm B?

Answer. Yes.

.129 APPENDIX B—Interpretation: Selecting the Review Year

1. Question. The standards for performing and reporting on peer reviews state that the review should cover a current period of one year to be mutually agreed upon by the reviewed firm and the review team. The standards also state that client engagements subject to review ordinarily should be those with years ending during the year under review unless a more recent report has been issued at the time the review team reviews engagements. What factors should be considered in selecting the review year?
2. Interpretation. It is contemplated that engagements for clients with fiscal year-ends corresponding with the review year-end will be included in the scope of review. Accordingly, the review team should schedule its engagement reviews over a period that takes into consideration the anticipated completion dates of such engagements. This is particularly important when the reviewed firm has a concentration of client engagements covering the same period as the review year.
3. As a practical matter, it is expected that most firms will select a review year-end from March 31 through September 30.

.130 APPENDIX C—Selecting Engagements for Review

1. The standards for performing and reporting on peer reviews state:

Engagements selected for review should provide a reasonable cross section of the reviewed firm's accounting and auditing practice, considering concentrations of engagements in specialized industries. In view of the special considerations involved, greater weight should be given to selecting engagements in which there is a significant public interest (such as publicly held clients, financial and lending institutions, and brokers and dealers in securities), and to selecting 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: a) one or more audits conducted pursuant to the Government Auditing Standards issued by the U.S. General Accounting Office (the "Yellow Book"); b) one or more audits conducted pursuant to the Employee Retirement Income Security Act of 1974 (ERISA); and c) one or more audits subject to Section 36 of the Federal Deposit Insurance Act.

2. The review team should attempt to achieve engagement coverage that meets all the above criteria. However, the review team frequently will find that meeting all of these criteria would cause it to substantially exceed the guidelines provided in the standards. In such circumstances, the review team should evaluate the initial selection of engagements in the manner indicated below.

- a. Has adequate consideration been given to the "key audit area" concept?

In the peer review of a small or medium-sized firm, selection of a large or complex audit for review might result in reviewing too much work. Applying the "key audit area" concept carefully to all selected engagements may keep the review team's time requirements within reasonable limits. (See "Extent of Engagement Review", PCPS §2000.69-.76, and "General Instructions to Reviewers" in the Peer Review Manual for discussion regarding emphasis on key audit areas.)

- b. Can the objectives inherent in the selection criteria be achieved without incurring excessive time?

Ordinarily, in applying the "key audit area" concept, all the key audit areas should be reviewed. The reviewer may

decide, however, not to review all key areas. For example, in some of the initial audit engagements selected for review, attention might be limited to client acceptance procedures, steps taken to gain knowledge and understanding of the client's business, the extent of evaluation of the client's systems and controls as a basis for developing an audit program, and an evaluation of the planned audit procedures. Similarly, in some specialized industry engagements selected for review, attention might be limited to an evaluation of the experience and training of the personnel assigned to the work, an evaluation of the planned audit procedures in areas unique to that industry, and a determination that the financial statements are appropriate in form for an entity operating in that industry. Likewise, a review of selected compilation engagements might be limited to reading the reports and financial statements to consider whether they appear to be in conformity with professional standards. In such cases, only the portion of total hours related to the key areas or aspects of an engagement actually reviewed should be included in the computation of the percentage of accounting and auditing hours that have been reviewed.

- c. Is too much weight being given to the desirability of reviewing work of most of the supervisory personnel?

The importance of reviewing some work performed by most supervisory personnel varies inversely with at least three factors: (1) the extent to which the firm has documented and communicated its quality control policies and procedures, (2) the extent to which the firm subjects its work to second-partner review or to review by an independent review function, and (3) the extent to which the firm's inspection program encompassed the work of supervisory personnel.

- d. Has adequate consideration been given in the selection of engagements to engagements selected for review in other offices?

For example, if two offices are selected for review and each has a large client in the same specialized industry, it ordinarily would not be necessary to review both engagements.

3. Selecting engagements for review and applying the considerations mentioned above require the application of professional judgment. However, it is important that reviewers do not avoid selecting engagements that meet the criteria simply because the guidelines for accounting and auditing hours to be reviewed might be substantially exceeded. It is preferable to

restrict the review procedures applied to an engagement that would otherwise consume an excessive amount of review time than to apply no procedures at all to that engagement.

.131 **APPENDIX D—Full Scope Reviews of Sole Practitioners With No Professional Staff Who Audit Historical or Prospective Financial Statements**

1. To achieve the objectives of a full scope peer review, 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. However, many sole practitioners believe that their reviews could be carried out at less cost if they were permitted to bring the required files, reports, and other evidential matter to the reviewer.
2. A review conducted at the reviewer's office or another agreed-upon location can achieve the objectives of an onsite peer review and can be described as such in the reviewer's report provided that (1) the reviewed firm is a sole practitioner with no professional staff; (2) the sole practitioner does not employ or engage other individuals to participate in the conduct of audit(s); (3) the sole practitioner has a personal meeting with the reviewer to discuss the practitioner's responses to the questions in the "Quality Control Policies and Procedures Questionnaire for Sole Practitioners With No Professional Staff" (the Questionnaire) and to discuss the reviewer's conclusions on the review; and (4) in addition to materials outlined in the "Instructions to Firms" (Division for CPA Firms Peer Review Manual §11,000), the sole practitioner sends the following materials to the reviewer prior to the review:
 - a. All documentation related to the resolution on 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. Documentation, if any, of consultations with outside parties during the year under review in connection with audit or accounting services provided to any client.

- d. A list of relevant technical publications used as research materials, such as: AICPA Professional Standards, AICPA industry audit guides, FASB pronouncements and/or GASB pronouncements, Governmental Auditing Standards and other government audit guides.
 - e. A list of audit and accounting materials, if any, identified in response to the questions in the "Supervision" section of the Questionnaire (Division for CPA Firms Peer Review Manual, PRM §13210.C)
 - f. CPE records sufficient to demonstrate compliance with state and AICPA continuing professional education requirements.
 - g. The relevant working paper files and reports on the engagements selected for review.
 - h. Any other evidential matter requested by the reviewer.
- 3. 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.
 - 4. A sole practitioner and the reviewer should mutually agree on the appropriateness of this approach to the peer review.

.132 APPENDIX E—Interpretation: Planning the Scope of a Peer Review

1. Planning a peer review is similar to planning an audit. Just as the performance of an audit entails audit risk, the performance of a peer review entails peer review risk. Peer review risk is the risk that the review team will:
 - a. fail to identify significant weaknesses in the reviewed firm's quality control system or compliance with it,
 - b. issue an inappropriate opinion on the reviewed firm's system of quality control for its accounting and auditing practice and/or compliance with that system, or
 - c. reach an inappropriate decision about whether to issue a letter of comments and/or about the findings to be included in or excluded from the letter of comments.
2. The reviewer should consider peer review risk in developing an overall strategy for the conduct and scope of the peer review. The nature, extent, and timing of planning procedures will vary with the size and complexity of the firm, experience with the firm, and knowledge of the firm's accounting and auditing practice.
3. In planning the scope of the peer review, the reviewer should:
 - a. Obtain an understanding of the nature and extent of the firm's accounting and auditing practice.
 - b. Obtain an understanding of the design of the firm's quality control system including an understanding of the scope and findings of inspections performed since the prior review.
 - c. Assess the overall attitude, awareness, and actions of firm management concerning the importance of quality work and its emphasis in the firm.
 - d. 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.

Selecting Offices and Engagements for Review

4. The number and type of engagements reviewed, when combined with testing the functional elements of quality control, 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 the quality control standards established by the AICPA and was complied with during the year under review.

5. Peer review standards contain guidelines that should be followed in determining the percent of accounting and auditing hours and the number of offices to be reviewed. However, the scope of the review may result in percentages higher or lower than these ranges depending upon the peer review risk and the knowledge obtained by the reviewer during the planning process.

Reasonableness of Scope

6. On a small firm, after making a preliminary engagement selection and considering peer review risk, the reviewer may find a large number of engagements and percentage of accounting and auditing hours selected. In such circumstances, the reviewer should apply the key area concept as discussed in Appendix C, 2000.130, "Selecting Engagements for Review."
7. As a conclusion to the planning process the reviewer should, prior to the conclusion of the review, reassess peer review risk and the adequacy of the scope of the review based on the results obtained to determine if additional procedures are necessary.

Documentation of Planning

8. Planning procedures should be documented in the summary review memorandum and other appropriate checklists and programs as described in these peer review standards.
9. The extent of such documentation is influenced by the number of factors to be considered and the complexities of the judgments to be made. Therefore, the reviewer may wish to prepare a comprehensive memorandum as an appendix to the summary review memorandum that further documents the planning considerations and procedures used to select the offices and engagements for review.

Summary

10. If the review team believes that the offices or engagements selected for review by applying the standards in this section do not result in a reasonable scope, the review team should consider consulting with the AICPA quality review division.

PCPS
2100

Peer Review Reports

GUIDELINES FOR AND ILLUSTRATIONS OF PEER REVIEW REPORTS

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2102 Standards for Performing and Reporting on Peer Reviews

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Guidelines for and Illustrations of Peer Review Reports

General Guidelines

- .01 A review team may issue one of the following types of reports:
 - a. An unqualified report
 - b. A qualified report (consisting of a modified or adverse opinion)
- .02 The report should contain:
 - a. An indication of the scope of the review, including any limitations thereon.
 - b. A description of the general characteristics of a system of quality control.
 - c. A reference to the letter of comments, if the report was modified or adverse.
 - d. An opinion on whether the reviewed firm's quality control system met the objectives of quality control standards established by the AICPA, and whether it was complied with to provide the firm with reasonable assurance of conforming with professional standards.
 - e. A description of the reason(s) for any qualification of the opinion.
 - f. 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 qualification.
- .03 The report should be issued on the reviewing firm's letter head and signed in the firm's name. All other reports should be issued on the letterhead of the entity that appointed or formed the review team and should be signed by the team captain on behalf of the review team (with out reference to the captain's firm).
- .04 The report should be addressed to the partners, proprietors, stockholders, or officers of the reviewed firm and should be dated as of the date of the exit conference.

- .05 The report should use plurals such as "we have reviewed"—even if the review team consists of only one person. The singular—"I have reviewed"—is appropriate only when the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

Guidelines For Writing Qualifying Paragraphs

- .06 In deciding on the type of opinion to be issued, a review team should consider the evidence it has obtained and form three overall conclusions with respect to the year being reviewed:
- a. Whether the policies and procedures that constitute the reviewed firm's system of quality control for its accounting and auditing practice met the applicable objectives of quality control standards established by the AICPA to the extent required to provide the firm with reasonable assurance of conforming with professional standards.
 - b. Whether personnel of the reviewed firm complied with such policies and procedures in order to provide the firm with reasonable assurance of conforming with professional standards.
 - c. Whether the reviewed firm complied with the membership requirements of the section in all material respects.

Report Modified for Design Deficiencies

- .07 A design deficiency exists when the reviewed firm's quality control policies and procedures, even if fully complied with, are not likely to accomplish an applicable quality control objective. Deficiencies in the design of a system of quality control would be significant, and a modified report should be issued, if the design of the system resulted in one or more quality control objectives not being accomplished, and as a result, a condition was created in which the firm did not have reasonable assurance of conforming with professional standards in its accounting and auditing practice during the year being reviewed.
- .08 The reason for the modification should be discussed in a separate paragraph after the standard first two paragraphs. The modifying paragraph should contain:
- a. A reference to the letter of comments such as, "As discussed in our letter of comments under this date, our review disclosed..."

- b. A description of the nature of the deficiency in the design of the firm's system of quality control. (The modifying paragraph should not discuss engagement deficiencies.)
 - c. A statement that the firm was not provided with reasonable assurance of conforming with professional standards on accounting and auditing engagements as a result of the design deficiencies.
- .09 The first sentence of the opinion paragraph of the standard report should be revised as follows:
- "In our opinion, except for the deficiency(s) described in the preceding paragraph, the system of quality control...."
- .10 Refer to PCPS §2100.31 for an illustrative report modified for design deficiencies.

Report Modified for Noncompliance with Quality Control Policies and Procedures

- .11 In assessing whether the degree of compliance was adequate to provide assurance of conforming with professional standards to the firm, the review team should consider the nature, causes, pattern, and pervasiveness of the instances of noncompliance noted. The review team should consider the implications of the degree of noncompliance for the firm's quality control system as a whole, not only their importance in the specific circumstances in which they were observed. If a review team concludes that the nature, causes, pattern, pervasiveness, or implications of instances of noncompliance are of such significance—individually or in the aggregate—that the reviewed firm's degree of compliance with its prescribed quality control policies and procedures did not provide it with reasonable assurance of conforming with professional standards, a modified report should be issued.
- .12 The reason for the modification should be discussed in a separate paragraph after the standard first two paragraphs. The modifying paragraph should contain:
- a. A reference to the letter of comments such as, "As discussed in our letter of comments under this date, our review disclosed..."
 - b. A description of the quality control policies and procedures that were not followed by professional staff. (The modifying paragraph should not discuss engagement deficiencies.)

- c. A statement that the firm's policies and procedures were not followed in a manner to provide the firm with reasonable assurance of conforming with professional standards on accounting and auditing engagements.
- .13 The first sentence of the opinion paragraph of the standard report should be revised as follows:
- "In our opinion, except for the deficiency(s) described in the preceding paragraph, the system of quality control...."
- .14 Refer to PCPS §2100.32 for an illustrative report modified for noncompliance with firm policies and procedures.

Report Modified for Noncompliance with Membership Requirements

- .15 The review team should evaluate whether the reviewed firm complied in all material respects with each of the membership requirements of the section. In evaluating the significance of instances 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 usually are more critical.
- .16 If a report is modified only for a failure to comply with one or more of the membership requirements of the section, a separate paragraph need not be added after the standard first two paragraphs. Rather, the last sentence of the opinion paragraph of the standard report should be deleted and the nature and extent of the noncompliance should be reported in a separate final opinion paragraph such as,
- "Also, in our opinion, except for..., the firm was in conformity with the membership requirements of the section in all material respects, as discussed in our letter of comments under this date."
- .17 Refer to PCPS §2100.33 for an illustrative report modified for noncompliance with membership requirements.

Report Modified for Noncompliance with Membership Requirements and Deficiencies in the System of Quality Control

- .18 If a report is modified for a failure to comply with one or more of the membership requirements of the section as well as for noncompliance with the firm's system of quality control, all the matters should be described in a separate paragraph after the standard first two paragraphs. The modifying paragraph should contain:

- a. A reference to the letter of comments such as, "As discussed in our letter of comments under this date, our review disclosed..."
 - b. A description of the nature and extent of the noncompliance with membership requirements and with the firm's quality control policies and procedures. (The modifying paragraph should not discuss engagement deficiencies.)
 - c. A statement that the deficiencies did not provide the firm with reasonable assurance of conforming with professional standards on accounting and auditing engagements.
- .19 The opinion paragraph of the standard report should be revised as follows:
- "In our opinion, except for the first deficiency described in the preceding paragraph, the system of quality control... of conforming with professional standards. Also, in our opinion, except for the second deficiency described in the preceding paragraph, the firm was in conformity...."
- .20 Refer to PCPS §2100.34 for an illustrative report modified for noncompliance with membership requirements as well as for noncompliance with the firm's policies and procedures.

Adverse Report

- .21 The review team should evaluate whether the reviewed firm's system of quality control met the objectives of quality control standards established by the AICPA, was being complied with, and provided the firm with reasonable assurance of conforming with professional standards. If the review team finds that there are significant deficiencies in the design of a system of quality control or pervasive instances of noncompliance with the firm's system of quality control as a whole, resulting in several material failures to adhere to professional standards on engagements, an adverse report may be appropriate.
- .22 The reasons for an adverse report should be discussed in a separate paragraph after the standard first two paragraphs. The paragraph should contain:
- a. A reference to the letter of comments such as "As discussed in our letter of comments under this date, our review disclosed..."

b. A description of the nature and extent of the deficiencies in the firm's system of quality control and whether the deficiencies were caused by an inappropriately designed system or noncompliance by professional staff.

c. A description of the engagement deficiencies, such as,

"In connection with these deficiencies, we noted 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."

.23 The opinion paragraph of the standard report should be revised as follows:

"In our opinion, because of the significance of the matters discussed in the preceding paragraph, the system of quality control for the accounting and auditing practice of Jones, Smith & Company in effect for the year ended June 30, 19__, did not meet the objectives of quality control standards established by the AICPA, was not being complied with during the year then ended, and did not provide the firm with reasonable assurance of conforming with professional standards. Also, 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."

.24 Refer to PCPS §2100.35 for an illustrative adverse report qualified for design deficiencies and noncompliance with the system of quality control.

Illustrative Reports

.25 The following paragraphs contain a standard illustrative report (PCPS §2100.26) and other illustrative reports. The standard report should be appropriately tailored to fit the circumstances. Following each illustrative report is a critique of "key points" that the review team should focus on when preparing a report.

.26 Standard Form For An Unqualified Report

[AICPA or Other Appropriate Letterhead]

September 30, 19__

To the Partners
Jones, Wilson & Co.

We have reviewed the system of quality control for the accounting and auditing practice of Jones, Wilson & Co. (the firm) in effect for the year ended June 30, 19__. Our review was conducted in conformity with standards for peer reviews promulgated by the peer review committee of the private companies practice section of the AICPA Division for CPA Firms (the section). 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)* and with the membership requirements of the section 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 and control of portions of engagements performed outside the United States.)**

In performing our review, we have given consideration to the general characteristics of a system of quality control as described in quality control standards issued by the AICPA. Such a system should be appropriately comprehensive and suitably designed in relation to the firm's organizational structure, its policies, and the nature of its practice. Variance in individual performance can affect 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.

* To be included, as appropriate, for reviews of multi-office firms.

** To be included for reviewed firms with offices, correspondents or affiliates outside the United States. The wording should be tailored if the reviewed firm's use of correspondent's or affiliates domestically is significant to the scope of the review.

In our opinion, the system of quality control for the accounting and auditing practice of Jones, Wilson & Co. in effect for the year ended June 30, 19__, 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. Also, in our opinion, the firm was in conformity with the membership requirements of the section in all material respects.

John Doe
Team Captain

or

Deary & Company

[for
review by
a firm]

or

John Doe
Team Captain

[for review by
an associa-
tion or state
CPA society
sponsored
review team]

.27 Unqualified Report on a Single Office Firm Performed by
Another Member Firm

SAMPLE AND ASSOCIATES
DALLAS, TX

September 30, 19__

To the Partners
John Doe and Company

We have reviewed the system of quality control for the accounting and auditing practice of John Doe and Company (the firm) in effect for the year ended June 30, 19__. Our review was conducted in conformity with standards for peer reviews promulgated by the peer review committee of the private companies practice section of the AICPA Division for CPA Firms (the section). We tested compliance with the firm's quality control policies and procedures and with the membership requirements of the section to the extent we considered appropriate. These tests included the application of the firm's policies and procedures on selected accounting and auditing engagements.

In performing our review, we have given consideration to the general characteristics of a system of quality control as described in quality control standards issued by the AICPA. Such a system should be appropriately comprehensive and suitably designed in relation to the firm's organizational structure, its policies, and the nature of its practice. Variance in individual performance can affect 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.

In our opinion, the system of quality control for the accounting and auditing practice of John Doe and Company in effect for the year ended June 30, 19__, 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. Also, in our opinion, the firm was in conformity with the membership requirements of the section in all material respects.

Sample & Associates

Key Points:

- o This is the standard unqualified report on a one office firm. Therefore, the scope paragraph does not include the phrase "at the firm's executive office and at selected practice offices in the United States."
- o The reviewed firm does not use correspondents or affiliates on accounting and auditing engagements. Therefore, the scope paragraph does not include the sentence referring to the test of the firm's supervision and control of portions of engagements.
- o This review was performed by another member firm. Therefore, the report has been issued on the letterhead of the reviewing firm and has been signed in the same manner that the firm signs a report on financial statements.

.28 Unqualified Report on a Multi-Office Firm With Offices, Correspondents, or Affiliates Outside the United States and All Offices Reviewed.

DEARY AND COMPANY
NEW YORK, NY

May 25, 19__

To the Partners
Lee, Seay & Company

We have reviewed the system of quality control for the accounting and auditing practice of Lee, Seay & Company (the firm) in effect for the year ended December 31, 19__. Our review was conducted in conformity with standards for peer reviews promulgated by the peer review committee of the private companies practice section of the AICPA Division for CPA Firms (the section). We tested compliance with the firm's quality control policies and procedures and with the membership requirements of the section 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 and control of portions of engagements performed outside the United States. In performing our review, we have given consideration to the general characteristics of a system of quality control as described in quality control standards issued by the AICPA. Such a system should be appropriately comprehensive and suitably designed in relation to the firm's organizational structure, its policies, and the nature of its practice. Variance in individual performance can affect 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.

In our opinion, the system of quality control for the accounting and auditing practice of Lee, Seay & Company in effect for the year ended December 31, 19__, 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. Also, in our opinion, the firm was in conformity with the membership requirements of the section in all material respects.

Deary and Company

Key Points:

- o The reviewed firm has offices, correspondents, or affiliates outside the United States and the review team tested the supervision and control of portions of engagements performed outside the United States. This fact has been reported in the last sentence of the scope paragraph. The wording should be tailored if the reviewed firm's use of correspondents or affiliates domestically is significant to the scope of the review.
- o The reviewed firm has two offices. Both offices were visited; therefore, the scope paragraph does not indicate that the review team tested compliance with the firm's system of quality control at the firm's executive office and at selected practice offices.
- o This review was performed by another member firm. Therefore, the report has been issued on the letterhead of the reviewing firm and has been signed in the same manner that the firm signs a report on financial statements.

.29 Unqualified Report on a Multi-Office Firm and Selected Practice Offices Reviewed

SEAWARD & GANNON
CERTIFIED PUBLIC ACCOUNTANTS
Philadelphia, PA

August 14, 19__

To the Partners
Ark & Company

We have reviewed the system of quality control for the accounting and auditing practice of Ark & Company (the firm) in effect for the year ended March 31, 19__. Our review was conducted in conformity with standards for peer reviews promulgated by the peer review committee of the private companies practice section of the AICPA Division for CPA Firms (the section). 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 and with the membership requirements of the section to the extent we considered appropriate. These tests included the application of the firm's policies and procedures on selected accounting and auditing engagements.

In performing our review, we have given consideration to the general characteristics of a system of quality control as described in quality control standards issued by the AICPA. Such a system should be appropriately comprehensive and suitably designed in relation to the firm's organizational structure, its policies, and the nature of its practice. Variance in individual performance can affect 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.

In our opinion, the system of quality control for the accounting and auditing practice of Ark & Company in effect for the year ended March 31, 19__, 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. Also, in our opinion, the firm was in conformity with the membership requirements of the section in all material respects.

Seaward & Gannon

Key Points:

- o In this example, the reviewed firm is a multi-office firm and all offices of the firm were not visited or reviewed. Therefore, the scope paragraph indicates this fact.
- o The reviewed firm does not use correspondents or affiliates on accounting and auditing engagements. Therefore, the scope paragraph does not include the sentence referring to the test of the firm's supervision and control of portions of engagements.
- o This review was performed by another member firm. Therefore, the report has been issued on the letterhead of the reviewing firm and has been signed in the same manner that the firm signs a report on financial statements.

.30 Unqualified Report on a Single Office Firm With No Auditing Practice and Performed by a Review Team Formed by an Authorized State CPA Society

THE STATE SOCIETY
OF CERTIFIED PUBLIC ACCOUNTANTS

October 7, 19__

To the Partners
Jackson & Allen, P.A.

We have reviewed the system of quality control for the accounting practice of Jackson & Allen, P.A. (the firm) in effect for the year ended July 31, 19__. (The firm had no auditing engagements during the year under review.) Our review was conducted in conformity with standards for peer reviews promulgated by the peer review committee of the private companies practice section of the AICPA Division for CPA Firms (the section). We tested compliance with the firm's quality control policies and procedures and with the membership requirements of the section to the extent we considered appropriate. These tests included the application of the firm's policies and procedures on selected accounting engagements.

In performing our review, we have given consideration to the general characteristics of a system of quality control as described in quality control standards issued by the AICPA. Such a system should be appropriately comprehensive and suitably designed in relation to the firm's organizational structure, its policies, and the nature of its practice. Variance in individual performance can affect 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.

In our opinion, the system of quality control for the accounting practice of Jackson & Allen, P.A. in effect for the year ended July 31, 19__, 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. Also, in our opinion, the firm was in conformity with the membership requirements of the section in all material respects.

Saul Lee
Team Captain

Key Points:

- o The reviewed firm has no audit engagements. Therefore, the scope and opinion paragraphs omit reference to the system of quality control for the auditing practice, the last sentence in the first paragraph indicates that "selected accounting engagements" were reviewed, and another sentence has been added parenthetically indicating that "the firm had no auditing engagements during the year under review."
- o The review was performed by a review team formed by an authorized state CPA society. Therefore, the report has been issued on the letterhead of the state CPA society and has been signed by the team captain.

- .31 Modified Report for a Supervision Design Deficiency on a Single Office Firm Performed by a Review Team Formed by an Association of CPA Firms

ASSOCIATION OF
LOCAL CPA FIRMS

December 20, 19__

To the Partners
Deary and Company

We have reviewed the system of quality control for the accounting and auditing practice of Deary and Company (the firm) in effect for the year ended September 30, 19__. Our review was conducted in conformity with standards for peer reviews promulgated by the peer review committee of the private companies practice section of the AICPA Division for CPA Firms (the section). We tested compliance with the firm's quality control policies and procedures and with the membership requirements of the section to the extent we considered appropriate. These tests included the application of the firm's policies and procedures on selected accounting and auditing engagements.

In performing our review, we have given consideration to the general characteristics of a system of quality control as described in quality control standards issued by the AICPA. Such a system should be appropriately comprehensive and suitably designed in relation to the firm's organizational structure, its policies, and the nature of its practice. Variance in individual performance can affect 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.

As discussed in our letter of comments under this date, our review disclosed that the firm's quality control policies and procedures for supervision were not appropriately designed because they do not include appropriate procedures for reviewing accountants' reports and accompanying financial statements in order to provide the firm with reasonable assurance of conforming with professional standards on accounting and auditing engagements.

In our opinion, except for the deficiency described in the preceding paragraph, the system of quality control for the accounting and auditing practice of Deary and Company in effect

for the year ended September 30, 19__, 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. Also, in our opinion, the firm was in conformity with the membership requirements of the section in all material respects.

John Doe
Team Captain

Key Points:

- o This report is modified for a design deficiency in the firm's quality control system for supervision. Therefore, it includes a description of the reasons for the modification. The description does not refer to engagement deficiencies.
- o The modifying paragraph of the report makes reference to the letter of comments.
- o The review was performed by a review team formed by an authorized association of CPA firms. Therefore, the report has been issued on the letterhead of the association and has been signed by the team captain.

.32 Modified Report for Noncompliance with Quality Control Policies and Procedures on a Single Office Firm Performed by a Committee-Appointed Review Team

[Division for CPA Firms' Letterhead]

PRIVATE COMPANIES PRACTICE SECTION
COMMITTEE-APPOINTED REVIEW TEAM #12345

May 30, 19__

To the Partners
Jackson, Allen and Associates

We have reviewed the system of quality control for the accounting and auditing practice of Jackson, Allen and Associates (the firm) in effect for the year ended December 31, 19__. Our review was conducted in conformity with standards for peer reviews promulgated by the peer review committee of the private companies practice section of the AICPA Division for CPA Firms (the section). We tested compliance with the firm's quality control policies and procedures and with the membership requirements of the section to the extent we considered appropriate. These tests included the application of the firm's policies and procedures on selected accounting and auditing engagements.

In performing our review, we have given consideration to the general characteristics of a system of quality control as described in quality control standards issued by the AICPA. Such a system should be appropriately comprehensive and suitably designed in relation to the firm's organizational structure, its policies, and the nature of its practice. Variance in individual performance can affect 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.

As discussed in our letter of comments under this date, our review disclosed that the firm's quality control policies and procedures for partner review of working papers and financial statements were not followed in a manner to provide the firm with reasonable assurance of conforming with professional standards.

In our opinion, except for the deficiency noted in the preceding paragraph, the system of quality control for the accounting and auditing practice of Jackson, Allen and Associates in effect for the year ended December 31, 19__, 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. Also, in our opinion, the firm was in conformity with the membership requirements of the section in all material respects.

Daniel Hall
Team Captain

Key Points:

- o This report is modified for noncompliance with the firm's quality control system. Therefore, it includes a description of the reasons for the modification. The description does not refer to engagement deficiencies.
- o The modifying paragraph of the report makes reference to the letter of comments.
- o The review was performed by a review team formed by the AICPA Quality Review Division. Therefore, the report has been issued on the Division for CPA Firms' letterhead and has been signed by the team captain.

.33 Modified Report for Noncompliance with Membership Requirements on a Single Office Firm Performed by a Committee-Appointed Review Team

[Division for CPA Firms' Letterhead]

PRIVATE COMPANIES PRACTICE SECTION
COMMITTEE-APPOINTED REVIEW TEAM #14321

October 11, 19__

To the Partners
St. John, Webster and Associates

We have reviewed the system of quality control for the accounting and auditing practice of St. John, Webster and Associates (the firm) in effect for the year ended June 30, 19__. Our review was conducted in conformity with standards for peer reviews promulgated by the peer review committee of the private companies practice section of the AICPA Division for CPA Firms (the section). We tested compliance with the firm's quality control policies and procedures with the membership requirements of the section to the extent we considered appropriate. These tests included the application of the firm's policies and procedures on selected accounting and auditing engagements.

In performing our review, we have given consideration to the general characteristics of a system of quality control as described in quality control standards issued by the AICPA. Such a system should be appropriately comprehensive and suitably designed in relation to the firm's organizational structure, its policies, and the nature of its practice. Variance in individual performance can affect 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.

In our opinion, the system of quality control for the accounting and auditing practice of St. John, Webster and Associates in effect for the year ended June 30, 19__, 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.

Also, 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 in all material respects, as discussed in our letter of comments under this date.

John Doe
Team Captain

Key Points:

- o The report is modified for noncompliance with the continuing professional education membership requirement. Therefore, the last sentence of the opinion paragraph of the standard report was deleted and the description of the reasons for the modification is reported in a separate final paragraph.
- o Reference to the letter of comments is made in the separate final paragraph that discusses the membership modification.
- o This review was performed by a review team formed by the AICPA Quality Review Division. Therefore, the report has been issued on the Division for CPA Firms' letterhead and has been signed by the team captain.

- .34 Modified Report for Noncompliance with Quality Control Policies and Procedures and with Membership Requirements on a Single Office Firm Performed by Another Member Firm.

ARK & ASSOCIATES
DALLAS, TX

October 11, 19__

To the Partners
Busel and Company

We have reviewed the system of quality control for the accounting and auditing practice of Busel and Company (the firm) in effect for the year ended June 30, 19__. Our review was conducted in conformity with standards for peer reviews promulgated by the peer review committee of the private companies practice section of the AICPA Division for CPA Firms (the section). We tested compliance with the firm's quality control policies and procedures with the membership requirements of the section to the extent we considered appropriate. These tests included the application of the firm's policies and procedures on selected accounting and auditing engagements.

In performing our review, we have given consideration to the general characteristics of a system of quality control as described in quality control standards issued by the AICPA. Such a system should be appropriately comprehensive and suitably designed in relation to the firm's organizational structure, its policies, and the nature of its practice. Variance in individual performance can affect 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.

As discussed in our letter of comments under this date, our review disclosed that the firm's quality control policies and procedures for consultation with designated parties outside the firm were not followed in a manner to provide the firm with reasonable assurance of conforming with professional standards. In addition, a significant number of professionals failed to participate in the required number of hours of qualifying continuing professional education, as required by the membership requirements of the section.

In our opinion, except for the first deficiency described in the preceding paragraph, the system of quality control for the accounting and auditing practice of Busel and Company in effect for the year ended June 30, 19__, 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. Also, in our opinion, except for the second deficiency described in the preceding paragraph, the firm was in conformity with the membership requirements of the section in all material respects.

Ark & Associates

Key Points:

- o The report is modified for significant noncompliance with the firm's policies and procedures and with membership requirements. Therefore, it includes a description of the reasons for the modification. The description does not refer to engagement deficiencies.
- o The modifying paragraph of the report makes reference to the letter of comments.
- o This review was performed by another member firm. Therefore, the report has been issued on the letterhead of the reviewing firm and has been signed in the same manner that the firm signs a report on financial statements.

.35 Adverse Report on a Single Office Firm Performed by a
Committee-Appointed Review Team

[Division for CPA Firms' Letterhead]

PRIVATE COMPANIES PRACTICE SECTION
COMMITTEE-APPOINTED REVIEW TEAM #12345

December 20, 19__

To the Partners
H. Leonine and Company

We have reviewed the system of quality control for the accounting and auditing practice of H. Leonine and Company (the firm) in effect for the year ended September 30, 19__. Our review was conducted in conformity with standards for peer reviews promulgated by the peer review committee of the private companies practice section of the AICPA Division for CPA Firms (the section). We tested compliance with the firm's quality control policies and procedures and with the membership requirements of the section to the extent we considered appropriate. These tests included the application of the firm's policies and procedures on selected accounting and auditing engagements.

In performing our review, we have given consideration to the general characteristics of a system of quality control as described in quality control standards issued by the AICPA. Such a system should be appropriately comprehensive and suitably designed in relation to the firm's organizational structure, its policies, and the nature of its practice. Variance in individual performance can affect 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.

As discussed in our letter of comments under this date, our review disclosed that the firm's quality control policies and procedures for review of engagement working papers and reports had not been complied with sufficiently to provide the firm with reasonable assurance of conforming with professional standards. In addition, our review disclosed that the firm's quality control policies and procedures for consultation were not appropriately designed because they do not provide the firm with reasonable assurance that personnel will seek assistance, to the extent necessary, from persons having appropriate levels of knowledge,

competence, judgment, and authority. In connection with these deficiencies, we noted 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 our opinion, because of the significance of the matters discussed in the preceding paragraph, the system of quality control for the accounting and auditing practice of H. Leonine and Company in effect for the year ended September 30, 19__, did not meet the objectives of quality control standards established by the AICPA, was not being complied with during the year then ended, and did not provide the firm with reasonable assurance of conforming with professional standards. Also, 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.

John Doe
Team Captain

Key Points:

- o The report is adverse because of significant deficiencies in the design of quality control and pervasive noncompliance with the firm's system of quality control as a whole. Therefore, it includes a description of the reasons for the adverse report. The description refers to engagement deficiencies.
- o The modifying paragraph of the report makes reference to the letter of comments.
- o The fourth paragraph of the report gives an adverse opinion on both the system of quality control and the firm's compliance with the membership requirements.
- o The review was performed by a review team formed by the AICPA Quality Review Division. Therefore, the report has been issued on the Division for CPA Firms' letterhead and has been signed by the team captain.

GUIDELINES FOR AND ILLUSTRATIONS OF THE LETTER OF COMMENTS

This guide has been developed by the AICPA Division for CPA Firms' Private Companies Practice Section Peer Review Committee, the SEC Practice Section Peer Review Committee and the AICPA Quality Review Executive Committee to provide practice monitoring reviewers with additional guidance on preparing letters of comments. The examples included in this section are for illustrative purposes only. Actual letters of comments should be prepared based on the specific facts and circumstances.

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Guidelines for and Illustrations of the Letter of Comments**Introduction**

- .01 The criteria for including an item in the Letter of Comments is whether the item resulted in a condition 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. Because this is a very low threshold, most reviews result in the issuance of a Letter of Comments.

Objectives

- .02 The major objectives of the letter are to—
- a. Report matters (including the matters, if any, that resulted in a qualified report) 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, and to set forth recommendations regarding those matters.
 - b. Provide information about the effectiveness of the firm's quality control system.
 - c. Provide the practice monitoring review committees and public oversight board, if applicable, with some of the information necessary to evaluate the appropriateness of the reviewed firm's responses to significant deficiencies noted in the review and whether the actions taken or planned by the firm appear appropriate in the circumstances.

General Guidelines

- .03 The letter should be addressed, dated, and signed in the same manner as the report. It should include—
- a. A reference to the report indicating if it was qualified.
 - b. A description of the purpose of the practice monitoring review.
 - c. A statement that the review was performed in accordance with the standards promulgated by the section.

- d. A description of any limitations on the scope of the review.
- e. A description of the limitations of a system of quality control.
- f. The reviewer's findings and recommendations.
- g. A statement that the matters discussed in the letter were considered in determining the opinion on the system of quality control.

Matters to be Included in the Letter of Comments

- .04 The letter of comments should include comments, as described below, regarding the design of the reviewed firm's system of quality control, or its compliance or documentation of its compliance with that system or with the membership requirements.¹ In addition, if a qualified practice monitoring review report is issued, the letter should include a section on the matters that resulted in the qualification. This section would ordinarily include an elaboration of the findings discussed in the qualifying paragraph of the report.
- .05 In order to give appropriate consideration to the evidence obtained and to reach conclusions regarding the matters to be included in the letter of comments, 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 during the review must be evaluated qualitatively and not primarily on a quantitative basis. Reviewers should take the necessary time to investigate findings and understand the underlying cause of the finding from the perspective of the quality control system.
- .06 The review findings should be based on professional standards and not on personal preferences. Reviewers are occasionally surprised to find that some "generally accepted professional standards" are, in reality, only a preferred treatment by their firm.

¹ Membership requirements are applicable only to SECPS and PCPS peer reviews. See SECPS §1000, "Organizational Structure and Functions of the SEC Practice Section," and PCPS §1000, "Organizational Structure and Functions of the Private Companies Practice Section," for additional information about the membership requirements.

- .07 If any of the matters to be included in the letter were included in the letter issued in connection with the firm's previous peer review or quality review, that fact ordinarily should be noted. The letter may also include comments concerning actions taken by the reviewed firm.

Reporting Considerations

Comments Regarding the Design of the Firm's Quality Control System

- .08 A design deficiency exists when the reviewed firm's quality control policies and procedures, even if fully complied with, are not likely to accomplish an applicable quality control objective.
- .09 Deficiencies in the design of the reviewed firm's quality control system should be included in the letter of comments if the design of the system resulted in one or more quality control objectives not being accomplished, and, as a result, a condition was created in which there was more than a remote possibility that the firm would not conform with professional standards on accounting and auditing engagements, even though there was reasonable assurance of conforming with professional standards.
- .10 When engagement deficiencies, particularly instances of non-conformity with professional standards, were attributable to such design deficiencies, the presence of the engagement deficiencies ordinarily should be noted in the comment along with the description of the design deficiency.²

Noncompliance with the Firm's Quality Control System

- .11 The best system of quality control can only be effective when the firm complies with that system. Although firms have good intentions for following their systems of quality control, other factors, such as lack of communication within the firm,

² For purposes of this section, professional standards refers to (a) currently effective pronouncements on professional standards issued by the American Institute of Certified Public Accountants (AICPA), (b) currently effective statements of financial accounting standards issued by the Financial Accounting Standards Board (FASB), (c) other materials issued by the AICPA or its committees and by the FASB, (d) government auditing standards, and (e) governmental accounting and financial reporting standards issued by the Governmental Accounting Standards Board.

lack of understanding of the system, and complacency can cause compliance problems.

- .12 Instances of noncompliance with significant firm policies or procedures, either because of a lack of performance or a lack of adequate documentation of performance, should be included in the letter whenever the degree of such noncompliance created a condition in which there was more than a remote possibility that the firm would not conform with professional standards on accounting and auditing engagements, even though the degree of noncompliance was not such as to warrant a qualified report.
- .13 Documentation deficiencies are deficiencies in which the reviewer has become convinced, through discussions with the members of the engagement team or other appropriate means, that the engagement team is knowledgeable about the matter under discussion and that the work in question was performed, but was not documented in the working papers.
- .14 In assessing whether the degree of noncompliance created a condition in which there was more than a remote possibility that the firm would not conform with professional standards on accounting and auditing engagements, the review team should consider the **nature, causes, pattern, and pervasiveness** of the instances of non-compliance noted, as well as the implications for the firm's quality control system as a whole, not merely the importance in the specific circumstances in which the instances were observed. In order to do this, the review team should evaluate the instances of non-compliance, both individually and collectively, recognizing that adherence to certain policies or procedures is more critical to assuring conformity with professional standards than adherence to others. Accordingly, a higher degree of compliance should be expected for the more critical policies and procedures. However, noncompliance with quality control policies and procedures that are less critical to assuring conformity with professional standards may also be reportable in a letter of comments. For example, a higher degree of noncompliance with a hiring policy relative to the obtaining of background information might be tolerated than with a policy which requires an independent partner to review the report and accompanying financial statements prior to issuance of the report.
- .15 When engagement deficiencies—particularly instances of non-conformity with professional standards—were attributable to instances of noncompliance with significant firm policies or

procedures that are described in the letter, that information ordinarily should be included in the description of the finding.

- .16 When the nature and degree of noncompliance at one or more offices of a multi-office firm were of such significance that a condition was created in which there was more than a remote possibility that the office would not conform with professional standards on accounting and auditing engagements, the review team should consider whether the matter should be included in the letter of comments; even though the degree of compliance for the remainder of the firm did not create such a condition with respect to the firm as a whole. In these instances, the identity of the office should not be revealed in the letter of comments.

Noncompliance with Membership Requirements

- .17 The review team should evaluate whether the firm complied in all material respects with each of the membership requirements. When the firm has not achieved a very high degree of compliance with a membership requirement—especially those directly related to the quality of performance on accounting and auditing engagements—that fact ordinarily should be included in the letter.³

Matters That Should Not be Included in the Letter of Comments

- .18 In the course of its work, a review team may note matters that do not merit reporting in the letter of comments because such matters do not create a condition in which there is more than a remote possibility that the firm will not conform with professional standards on accounting and auditing engagements. However, such matters may be communicated to the firm orally.⁴ Examples of such matters are described in the following paragraphs.

³ Ibid., footnote 2.

⁴ For PCPS peer reviews and quality reviews such matters may be communicated in a written letter of suggestions. This letter should be prepared on the letterhead of the team captain's firm since it is a private communication between the team captain and the reviewed firm only. A copy of this letter should not be included in the working papers.

Apparent Deficiencies in Design or Compliance Wholly or Partially Offset by Other Compensating Policies and Procedures

- .19 If a firm's quality control system does not include a procedure that the review team considers significant (such as the use of a financial statement disclosure or report review checklist) but it does include other compensating procedures (such as a second management-level pre-issuance review that is functioning effectively), the matter should not be included in the letter. The design deficiency is offset by other compensating procedures and no further action is required.

Recommendations Regarding the Firm's Quality Control Document

- .20 Reviewers may notice that a firm's quality control document does not provide for all circumstances that may arise. For example, a firm may not have established consultation policies relative to specialized industries, because at the present time, it has no clients in any specialized industries. Such matters may be discussed with the reviewed firm; however, they should not be included in the letter of comments.
- .21 Reviewers may find that a firm does not comply with certain policies and procedures that, in practice, are excessive or redundant and not necessary to assure conformity with professional standards on accounting and auditing engagements. Such findings should be discussed with the firm, but they should not be included in the letter of comments.

Isolated Occurrences

- .22 Ordinarily, an isolated instance of noncompliance should not be included in the letter. However, the review team should evaluate the nature, significance, and cause of the isolated occurrence and its implications for the firm's quality control system, as a whole. The review team also should consider the results of its evaluation in conjunction with its other instances of noncompliance findings to determine if the item does, in fact, represent an isolated occurrence. For example, a single disclosure deficiency, an instance of noncompliance with a quality control procedure, and a single documentation deficiency may all appear to be isolated but, in fact, may have resulted from the same underlying cause. Such instances of noncompliance should be included in the letter of comments if they created a condition in which there was more than a remote possibility that the firm would not conform with professional standards on accounting and auditing engagements.

Administrative Matters

- .23 Matters relating to poor firm administration or engagement inefficiencies ordinarily do not create a condition in which there is more than a remote possibility that the firm will not conform with professional standards on accounting and auditing engagements. Therefore, such matters should not be reported in a letter of comments.

Points to Consider When Writing the Letter of Comments

- .24 The objectives of the letter of comments are more likely to be met when the letter is written in a clear, concise manner. The following points should be considered when writing a letter:
- a. If a qualified report is issued, the letter should be divided into two sections: (a) Matters that resulted in a modified (adverse) report, and (b) Matters that did not result in a modified (adverse) report. However, if the report is not qualified, do not include the phrase "matters that did not result in a modified (adverse) report."
 - b. Use the format recommended in this section of "findings" and "recommendations for improvement." Separate, clearly captioned paragraphs should be used to report the findings and related recommendations.
 - c. Include headings for each quality control element for which there is a comment.
 - d. Items included in the letter should have a "systems" orientation. That is to say, identify the underlying weakness in the quality control system which caused a particular engagement deficiency to occur. It should not just describe the engagement deficiency.
 - e. Identify the likely causes of the deficiencies (for example, describe the deficiencies as either design deficiencies or compliance deficiencies [performance or documentation]).
 - f. Group findings caused by the same deficiency into a single comment. For example, if the review team notes various disclosure deficiencies that are caused by the failure to use a disclosure checklist or to perform other appropriate procedures, a single comment on the cause of all the disclosure deficiencies is preferable to numerous comments on individual deficiencies. The letter should

not list each disclosure deficiency noted by the review team.

- g. Do not group unrelated findings into one comment. For example, disclosure deficiencies should be separated from comments regarding insufficient documentation unless they relate to the same quality control deficiency.
- h. Describe the findings in a complete manner, but avoid excessive or unnecessary detail in the letter of comments.
- i. Use general terms to indicate frequency of occurrence. Terms such as "in some instances" or "frequently" are preferable to the specific number of instances.
- j. Do not identify specific engagements, individuals, or offices by name or otherwise. For example, do not refer to "The firm's SEC engagement".
- k. Do not include personal preferences in the letter when they relate to procedures (such as engagement letters or time budgets) that are not required by the firm's quality control system and are not essential to the reviewed firm's conformity with professional standards on accounting and auditing engagements. Such matters may be communicated to the firm orally.
- l. Avoid references to specific technical standards, where possible. In most instances, a general reference to "professional standards" will suffice. If a reference to a specific technical standard is necessary, always include a complete description of the topic to which it relates.
- m. When a finding describes a performance deficiency where the firm may have departed from professional standards, include a sentence advising the reader whether additional actions are necessary on the engagement reviewed ("close the loop"). If corrective actions are necessary, a description of the actions taken or planned by the reviewed firm should be included. Ordinarily, the reviewer need not "close the loop" for documentation deficiencies.
- n. Use general terms when referring to purchased practice aids, instead of the names of specific publishers.

- o. If any of the matters to be included in the letter of comments were included in the letter issued in connection with the firm's previous peer or quality review, this fact ordinarily should be noted in describing the matter. In this regard, comments should not be written in a general manner such that they may be "automatically repeated" in the documents issued in connection with the firm's next review.
- p. Be careful not to overemphasize the use of standardized forms and checklists as a recommendation for improving the firm's quality control system. Although forms and checklists may be helpful in many circumstances, their use will not cure all deficiencies. Think carefully about the cause of the deficiency and whether a more effective recommendation would provide a cure.
- q. Have someone in your firm unfamiliar with the findings on the review read the letter of comments before it is finalized. Ask them whether they understand the findings and recommendations without asking any questions.

General Guidelines For Describing the Review Team's Findings

- .25 In describing a deficiency in the design of the reviewed firm's system or instances of noncompliance, the findings ordinarily can be described in the following manner:
 - a. Design deficiency—(1) state what the system does or does not require; (2) if appropriate, state whether engagement deficiencies—particularly those that caused the reviewers to conclude that the reviewed firm (a) should consider taking action pursuant to the AICPA Professional Standards, vol. 1, AU sections 390 and 561 or (b) lacked a reasonable basis under the standards for accounting and review services for the reports issued—were attributable to the design deficiency; and (3) describe the effect, if any, that the deficiency had on the financial statements issued.
 - b. Instances of noncompliance (performance or documentation)—(1) state what the system requires; (2) state the frequency of noncompliance in general terms; (3) if appropriate, state whether engagement deficiencies—particularly those that caused the reviewers to conclude that the reviewed firm (a) should consider taking action pursuant to the AICPA Professional Standards, vol. 1, AU sections 390 and 561, or (b) lacked a reasonable basis under the standards for accounting and review services for the reports issued—were attributable to the instances

of noncompliance; and (4) describe the effect, if any, that the instances of noncompliance had on the financial statements issued.

.26 Under the above guidelines:

- a. A good way to start a letter of comment finding would be with the following words: "The firm's quality control policies and procedures...." Then go on to state what the system does or does not require. This informs the reader of the status of the quality control system.
- b. The second sentence of the finding explains the result, such as "As a result...." or "However, the firm did not always comply with these policies and as a result...."
- c. The last sentence should "close the loop" if the finding relates to an engagement performance deficiency. Some examples of "closing the loop" are:
 - o None of the missing or incomplete disclosures represented significant departures from professional standards.
 - o None of the missing disclosures were of such significance to make the financial statements misleading.
 - o We noted financial statements that did not include all of the disclosures required by generally accepted accounting principles, and, in one instance, financial statements that were materially misstated. The report on the latter financial statements has been recalled, and the financial statements are being revised.
 - o We were satisfied that the firm performed the necessary procedures even though they were not documented.
 - o We found one engagement in which, as a result of a lack of involvement by the engagement partner in planning the audit, the work performed on receivables and inventory did not appear to support the firm's opinion on the financial statements. As a result of this finding, the firm performed the necessary additional procedures to provide a satisfactory basis for its opinion.

- .27 Appendix A illustrates how the foregoing matters may be covered in a letter of comments under the peer review programs.
- .28 Appendix B illustrates how the foregoing matters may be covered in a letter of comments under the quality review program.
- .29 Appendix C contains a checklist for reviewing drafts of letters of comments.
- .30 Appendix D contains illustrative examples of poorly written letter of comments items.

**Illustrative Examples That Might be Included
in the Letter of Comments**

- .31 The rest of this section contains illustrative examples of items that might be included in letters of comments.
- .32 A reviewer must evaluate whether the reviewed firm's system meets the objectives of the quality control standards applicable to its practice and whether the system was being complied with to provide the firm with reasonable assurance of conforming with professional standards. By considering the nature, cause, pattern and pervasiveness of a particular deficiency or group of deficiencies, a reviewer will decide whether a peer review report should be qualified, or a matter should be included in a letter of comments, communicated orally, or not communicated at all based on:
 - a. The extent to which the designed system meets these objectives, and
 - b. The instances of noncompliance with the policies and procedures established by the firm.

As a result, some of the examples may warrant the issuance of a qualified report in certain circumstances, while an unqualified report will be appropriate in other situations with the matter being included in the letter of comments or communicated orally.

Independence**Quality Control Objective**

.33 Statement on Quality Control Standards No. 1 states that—

Policies and procedures should be established to provide the firm with reasonable assurance that persons at all organizational levels maintain independence to the extent required by the rules of conduct of the AICPA. Rule 101 of the rules of conduct contains examples of instances wherein a firm's independence will be considered to be impaired.⁵

Illustrative Examples of Design Deficiencies

.34 **Finding**—The firm's independence policies and procedures have been appropriately communicated to the firm's professional personnel through its quality control document and through training programs. However, the firm's policies and procedures do not require that professional personnel be informed of all new attest engagements on a timely basis. Nonetheless, we were able to determine that the firm's independence had not been impaired on any attest engagements.

Recommendation for Improvement—The firm should, on a periodic basis, communicate in writing to all personnel new attest engagements accepted by the firm. This communication should also request that any personnel with a possible independence problem with respect to the new engagements contact the administrative partner immediately.

.35 **Finding**—The firm's independence policies and procedures do not require confirmation of the independence of another firm engaged to perform segments of an engagement. As a result, on the firm's only engagement where it was the principal auditor, there was no documentation indicating that the firm engaged to perform a segment of the engagement was independent of the client. Through discussions with firm personnel, it was determined that the firm had received an oral representation from the correspondent firm that it was independent.

Recommendation for Improvement—We recommend that the firm's policies and procedures be revised to require that a written

⁵ AICPA Professional Standards, Vol. 2, QC §10.07.

independence representation be obtained from other firms engaged to perform segments of an engagement when the firm is acting as the principal auditor.

- .36 Finding—The firm's quality control policies and procedures require appropriate evaluation and resolution of all questions regarding independence. However, the firm does not require that such resolutions be documented. As a result, the firm did not document the resolution of several independence matters that were identified by its staff in their annual independence statements. However, we were able to satisfy ourselves that appropriate resolutions had been reached.

Recommendation for Improvement—We recommend that the firm's quality control policies and procedures be revised to require documentation of the resolution of independence questions.

Illustrative Examples of Compliance Deficiencies

- .37 Finding—The firm's quality control policies and procedures require that written independence representations be obtained annually from all partners and professional staff. During our review, we noted that several of the firm's professional staff had failed to sign such a representation. However, we did not note any instances where the firm was not independent with respect to the financial statements on which it reported.

Recommendation for Improvement—We recommend that the firm re-emphasize its policy of obtaining annual independence representations from all professional personnel. The firm should also ensure that all professionals understand the firm's independence policies and that they disclose instances where they are not independent of the firm's clientele.

- .38 Finding—The firm's quality control policies and procedures require an evaluation and resolution of all questions regarding independence, including a review of its accounts receivable for unpaid fees on continuing clients. Our review disclosed an instance where the firm issued a report on a client's financial statements before the prior year's fee had been paid. As a result, the independence of the firm was considered impaired. The firm has recalled its report and disclaimed an opinion with respect to the financial statements.

Recommendation for Improvement—The firm should reemphasize its policy of evaluating and resolving all independence issues. We also recommend that the firm's partners comply with the firm's policy of determining whether there are any prior year unpaid fees prior to issuance of any report on financial

statements and, if so, to ensure that those fees are paid prior to the issuance of the report for the current year.

Assigning Personnel to Engagements

Quality Control Objective

.39 Statement on Quality Control Standards No. 1 states that—

Policies and procedures for assigning personnel to engagements should be established to provide the firm with reasonable assurance that work will be performed by persons having the degree of technical training and proficiency required in the circumstances. In making assignments, the nature and extent of supervision to be provided should be taken into account. Generally, the more able and experienced the personnel assigned to a particular engagement, the less is the need for direct supervision.⁶

Illustrative Examples of Design Deficiencies

.40 Finding—The firm's quality control policies and procedures require that personnel assigned to an engagement have sufficient experience to perform the work assigned to them. However, the firm has not established adequate procedures to identify staffing requirements for specific engagements. As a result, on several engagements reviewed, certain complex procedures performed by its personnel were not performed properly. The firm has subsequently performed alternative auditing procedures on the respective engagements.

Recommendation for Improvement—The firm should revise its policies and procedures to establish specific procedures for planning personnel needs for the overall firm and identifying staffing requirements for specific engagements. This may be accomplished by assigning one individual the responsibility for assigning personnel to engagements and for coordinating the resolution of scheduling problems.

.41 Finding—The firm's quality control policies and procedures do not require that the person responsible for assigning personnel to engagements consider special industry knowledge when assigning all levels of personnel to engagements. We noted that the firm relies heavily on the engagement partner's

⁶ Ibid., footnote 5.

background and knowledge and does not give adequate consideration to the complexity or other requirements of the engagement when assigning other engagement personnel. On several engagements, we noted instances in which certain personnel did not have sufficient experience or training in the areas assigned to them. As a result, the firm did not properly report on several financial statements in a specialized industry. The firm has appropriately recalled and reissued all of the reports.

Recommendation for Improvement—The engagement partner should ascertain that personnel assigned to engagements have sufficient experience to perform the work assigned to them. When it is necessary to assign a person to perform a key role on an engagement who does not have sufficient experience to handle all the work assigned, the partner should document how the engagement team will compensate for this lack of experience.

Illustrative Examples of Compliance Deficiencies

- .42 **Finding**—The firm's quality control policies and procedures require that engagement partners evaluate planning schedules to ensure that the personnel assigned to an engagement have sufficient experience to perform the work assigned to them. However, on some engagements reviewed, the personnel below the partner level did not appear to have adequate experience to handle their work. As a result, certain procedures were not performed properly. The firm has considered the requirements of professional standards, and has determined that enough procedures had been performed in other areas to support the report issued on the financial statements.

Recommendation for Improvement—The firm should reemphasize its policies and procedures that require the partner on each engagement to ascertain that the personnel assigned to the engagement have sufficient experience to perform the work assigned to them. When it is necessary to assign a person to a key role on an engagement who does not have sufficient experience to handle all the work assigned to him or her, the engagement partner should document how the engagement team will compensate for this change from firm policy.

Consultation**Quality Control Objectives**

.43 Statement on Quality Control Standards No. 1 states that—

Policies and procedures for consultation should be established to provide the firm with reasonable assurance that personnel will seek assistance to the extent required from persons having appropriate levels of knowledge, competence, judgment, and authority. The nature of the arrangements for consultation will depend on a number of factors, including the size of the firm and the levels of knowledge, competence, and judgment possessed by the persons performing the work.⁷

Illustrative Examples of Design Deficiencies

.44 **Finding**—Our review disclosed that the firm's consultation policies and procedures do not identify situations where, because of the nature or complexity of the subject matter, consultation ordinarily is needed. As a result, we noted a few instances where consultation was lacking when it would have been appropriate. These instances did not, however, result in the issuance of an inappropriate report.

Recommendation for Improvement—The firm should revise its quality control policies and procedures to specify the situations where, because of their nature or complexity, consultation is required. Such situations might include the following: (1) the application of newly issued technical pronouncements, (2) the application of a regulatory agency's filing requirements, (3) industries with special accounting, auditing, or reporting considerations, (4) emerging practice problems, and (5) cases where there is a choice among alternative generally accepted accounting principles.

.45 **Finding**—Our review disclosed that the firm's consultation policies and procedures do not provide procedures for resolving differences of opinion among engagement personnel and specialists. We noted no instances in which differences of opinion on practice problems had not been resolved to the satisfaction of all the parties involved, even though the

⁷ Ibid., footnote 5.

individuals indicated that they did not have a clear understanding of the steps to be followed in such circumstances.

Recommendation for Improvement—We recommend that the firm revise its quality control policies and procedures to describe the procedures for resolving differences of opinion among engagement personnel and specialists. These procedures should then be communicated to all professional personnel.

- .46 Finding—The firm's policies and procedures do not provide a means for ensuring that its library contains all relevant technical manuals. Our review disclosed that the firm's reference library contains outdated technical manuals and lacks industry audit and accounting guides in many of the industries in which the firm's clients operate. As a result, we noted a few instances where financial statement formats and disclosures deviated from these guides. However, none of these instances caused the statements to be misleading.

Recommendation for Improvement—We recommend that the firm's quality control policies and procedures be revised to ensure that the firm's library contains all relevant materials. The firm may wish to consider assigning one person the responsibility of ensuring that the library is comprehensive and up-to-date and that it includes all the industry auditing and accounting guides for the industries in which the firm's clients operate.

Illustrative Examples of Compliance Deficiencies

- .47 Finding—The firm's quality control document identifies areas and specialized situations where consultation and the documentation thereof is required. Our review disclosed several instances where consultation should have taken place, but there was no documentation of such consultation in the working papers. However, through discussions with engagement partners, we were able to satisfy ourselves that the staff had consulted as required.

Recommendation for Improvement—We recommend that the firm reemphasize the importance of documenting consultations to its professional staff. The firm should consider requiring the documentation to be reviewed and approved by the person consulted.

- .48 Finding—The firm's quality control policies and procedures identify situations where, because of the nature or complexity of the subject matter, consultation ordinarily is needed. During our review, we noted a few instances where the firm appropriately consulted with outside sources; however,

they failed to reconcile a difference between the advice of the outside source and the requirements of professional standards. As a result, the firm did not issue certain reports that are required in a regulated industry. Subsequent to the peer review, the firm issued those reports.

Recommendation for Improvement—We recommend that, in addition to consulting outside sources when necessary, the firm also consult the appropriate technical literature. If differences do arise between these sources, then the firm should take steps to reconcile the differences.

- .49 Finding—The firm's quality control policies and procedures state that when experience is not available within the firm to resolve a practice question or problem, the engagement partner should consult with the AICPA or the state CPA society. Our review disclosed an instance where the firm did not have the experience required and did not consult with the AICPA or the state CPA society as required. In this instance, a partner designated as a specialist in another industry was consulted, but the advice rendered resulted in the misapplication of a generally accepted accounting principle. Since the amount involved did not make the financial statements misleading, the firm did not have to recall its report; the client has agreed, however, to adjust the financial statements in the next period in which they are prepared.

Recommendation for Improvement—We recommend that the firm reemphasize the importance of consulting the appropriate authorities. Designated specialists should also be reminded that they should not exceed their authority in consultative situations by providing advice in areas outside their expertise.

- .50 Finding—The firm's policies and procedures require consultation in situations that involve complex subject matter or newly issued technical pronouncements. During our review, we noted several instances where the firm did not consult, but should have. The firm issued several reports on financial statements prepared on a basis of accounting prescribed by a regulatory agency for filing with that agency. However, the auditors' reports issued did not include all required wording to comply with professional standards. The reporting deficiencies were not of such significance to make the auditors' reports misleading.

Recommendation for Improvement—The firm should reemphasize its policies regarding consultation as outlined in its quality control document. The firm should encourage its staff to

consult with or use authoritative sources on complex or unusual matters.

Supervision

Quality Control Objective

.51 Statement on Quality Control Standards No. 1 states that—

Policies and procedures for the conduct and supervision of work at all organizational levels should be established to provide the firm with reasonable assurance that the work performed meets the firm's standards of quality. The extent of supervision and review appropriate in a given instance depends on many factors, including the complexity of the subject matter, the qualifications of the persons performing the work, and the extent of consultation available and used. The responsibility of a firm for establishing procedures for supervision is distinct from the responsibility of individuals to adequately plan and supervise the work on a particular engagement.⁸

Illustrative Examples of Design Deficiencies

.52 Finding—The firm's policies and procedures require the engagement partner to review the firm's reports and the accompanying financial statements before they are issued. Although not required by professional standards, the firm does not use disclosure checklists as an aid in the review of financial statements. On several engagements reviewed, the financial statements did not include all the disclosures required by generally accepted accounting principles, particularly in the areas of related party transactions and leases. None of the missing disclosures were of such significance to make the financial statements misleading.

Recommendation for Improvement—The firm should revise its quality control policies and procedures for ensuring that clients' financial statements include all relevant disclosures, such as by obtaining or developing comprehensive reporting and disclosure checklists. The firm should then amend its quality control policies and procedures to require

⁸ Ibid., footnote 5.

that these checklists be completed by a member of the engagement team, reviewed by the engagement partner, and retained with the engagement working papers.

- .53 **Finding**—The firm's quality control policies and procedures do not specify the working papers that should be reviewed by engagement partners or require any documentation of the partner's reviews. While reviewing engagements, we were unable to determine from the working papers the extent of the engagement partner's review. This did not result in the issuance of an inappropriate report.

Recommendation for Improvement—The firm should revise its quality control policies and procedures to specify the extent and nature of the engagement partner's review of work papers, and require documentation of the extent of the review. Such documentation can be in the form of initialing the working papers, file covers, or a partner review checklist.

- .54 **Finding**—The firm's quality control policies and procedures require that all accounting and auditing engagements be properly planned. However, the firm does not provide specific procedures for documenting its engagement planning, including the consideration of audit risks and preliminary judgments about materiality limits. During the review of engagements, we noted several instances where we could not determine if the firm had considered preliminary judgments about materiality or its assessment of control risk. Through discussion with firm personnel, we satisfied ourselves that appropriate planning procedures had been performed.

Recommendation for Improvement—The firm should revise its policies and procedures to designate those matters that should be considered and documented during the planning process. These may include such areas as (1) current economic conditions affecting the client or the client's industry and the potential effect on the conduct of the engagement, (2) results of preliminary analytical procedures, (3) changes in the client's organization, (4) need for specialized knowledge, (5) proposed work programs, and (6) preliminary judgments about materiality levels. In establishing such policies, the firm should consider obtaining or designing a planning checklist or requiring the preparation of an overall planning memorandum.

- .55 **Finding**—The firm requires that its model audit program be used on all audit engagements. However, the firm does not require that this program be tailored to cover the requirements of specialized industries, when necessary. Our review of engagements disclosed that, while the audit program had not

been tailored to reflect special industry requirements, the procedures performed were appropriate and sufficient in the circumstances.

Recommendation for Improvement—The firm's planning policies and procedures should be expanded to include a review and, when necessary, tailoring of the audit program before the start of field work. The firm should consider obtaining or developing audit programs that are reflective of the specialized industries in which its clients operate.

- .56 **Finding**—The firm does not provide its professional staff with a means of ensuring that all necessary procedures are performed on review and compilation engagements. As a result, the firm's review and compilation working papers did not include documentation of all the procedures required by firm policy or professional standards. However, we were able to satisfy ourselves that, in each case, sufficient procedures had been performed.

Recommendation for Improvement—Although not required by professional standards, the firm should consider obtaining or developing work programs for use on review and compilation engagements.

- .57 **Finding**—The firm's policies and procedures do not require documentation of sample selections and evaluation of the results of sampling applications. During our review of engagements, we noted several instances where the firm performed non-statistical sampling, but did not document its considerations. Through discussions with firm personnel, we were able to satisfy ourselves that adequate procedures had been performed.

Recommendation for Improvement—The firm should revise its policies and procedures to require documentation of sample selections and evaluation of sampling results for statistical and nonstatistical sampling. This may be accomplished by obtaining or developing a standardized form that conforms to the guidance included in professional standards.

- .58 **Finding**—The firm's quality control policies and procedures do not require documentation of its understanding of an entity's internal control structure on engagements for which it has assessed control risk at the maximum level. As a result, on several engagements reviewed there was no documentation in the working papers of the firm's understanding of the internal control structure of the client. However, we were satisfied that the firm has a good understanding of the client's

internal control structure and that the audit was properly planned.

Recommendation for Improvement—The firm should revise its policies and procedures to require documentation of its understanding of internal control structures on all audit clients as required by professional standards. Such documentation may be in the form of a memorandum in the working papers.

- .59 Finding—The firm has acquired accounting and auditing practice aids from a third-party provider. Our review disclosed that the firm has selectively used these materials in conjunction with materials from other sources without carefully reviewing the compatibility of the materials. As a result, on the audit engagements reviewed, the programs and checklists used did not address certain aspects of engagement planning, particularly preliminary analytical review, audit risk assessment, and consideration of an entity's internal control structure. These areas were not adequately documented in the engagement workpapers; however, we were able to satisfy ourselves that, in each case, these areas were appropriately considered in determining the nature and extent of auditing procedures.

Recommendation for Improvement—We recommend the firm review the materials obtained from the third-party provider and determine how they can best be implemented in the firm's accounting and auditing practice. The use of other materials for specialized areas should be blended with the new materials in such a way that engagement planning is adequately addressed.

- .60 Finding—The firm's policies and procedures for reviewing accountant's reports and financial statements before issuance are not adequately designed to ensure compliance with professional standards. During our review, we noted that on several compilation and review engagements the accountant's report did not describe what responsibility, if any, the accountant was taking in regards to accompanying supplementary information. Also, we found some occasions where the supplementary information was not referenced to the accountant's report. In all cases, supporting working papers were present to indicate an appropriate level of service had been performed on the supplementary information. The firm's inspection program did identify this situation and use of a disclosure checklist was instituted subsequent to the year under review. No deficiencies in this area were noted subsequent to the introduction of the disclosure checklist.

Recommendation for Improvement—Although not required by professional standards, the firm should implement the use of reporting and disclosure checklists on all engagements. Continued monitoring of its use through the inspection process will help ensure adherence to the firm's quality control standards.

- .61 Finding—The firm's policies and procedures require the engagement partner to review the accountants' or auditors' reports and accompanying financial statements before they are issued. However, the firm does not use other quality control materials as an aid in reviewing reports and financial statements, nor does it require a pre-issuance review of financial statements by a partner not associated with the engagement. During our review, we noted instances where the accountant's reports did not report on supplementary data included in the financial statements. In addition, an auditor's report prepared on a basis prescribed by a regulatory agency did not include the appropriate wording required by professional standards. None of the reporting deficiencies were misleading.

Recommendation for Improvement—The firm should reemphasize to its partners the importance of thoroughly reviewing auditor reports and accompanying financial statements before issuance. In addition, the firm should obtain or develop a comprehensive reporting checklist. The firm should then amend its quality control policies and procedures to require its use on all engagements, and require the engagement partner to review the checklist prior to issuance of the accountants' or auditors' reports.

Illustrative Examples of Compliance Deficiencies

- .62 Finding—The firm's policies and procedures require the use of standard programs on audit engagements for the review of EDP controls. However, we noted that these programs were not always used. As a result, audit working papers did not include documentation of the firm's understanding of its clients' EDP controls. We were able to satisfy ourselves that a sufficient review of these controls had been performed in accordance with professional standards.

Recommendation for Improvement—The firm should reemphasize, to its supervisory personnel, its policy of using standard programs to review EDP controls. All partners should be advised to monitor compliance with this policy when reviewing audit working papers. Further, the firm should consider adding a step to its planning checklist to ensure that EDP programs have been completed.

- .63 **Finding**—On several of the engagements reviewed, we noted that a review by a partner having no other responsibility for the engagement had not been performed as required by firm policy. On these engagements, we noticed that several disclosures required by generally accepted accounting principles were omitted from the financial statements. However, none of the missing disclosures were of such significance to make the financial statements misleading.

Recommendation for Improvement—The firm should comply with its policy of having a second partner review each engagement. To insure compliance with this policy, the firm should require that the second partner initial the report control sheet before the report is issued.

- .64 **Finding**—The firm's audit programs outline steps for performing and documenting audit planning procedures for preliminary judgments about materiality levels, planned assessed level of control risk, analytical review procedures and conditions that may require extension or modification of tests. However, our review disclosed several instances where the firm's planning working papers did not include documentation for these areas. Through discussion with engagement personnel, we were able to satisfy ourselves that the engagement planning was adequate.

Recommendation for Improvement—The firm should remind all professionals of the matters to be considered when planning an audit engagement and of its documentation requirements. In addition, the firm may consider obtaining or developing a planning checklist to assist staff when planning an audit engagement and documenting the results thereof.

- .65 **Finding**—The firm's policies and procedures require communication of reportable conditions noted during an audit to client management in accordance with professional standards. During our review, however, we noted instances where the communication of reportable conditions in internal accounting controls was not documented. Although the firm has represented that the reportable conditions were communicated orally to its client, there was no memorandum or notation in the working papers as required by professional standards.

Recommendation for Improvement—The firm should reemphasize the importance of adhering to professional standards regarding documentation of communication of reportable conditions. The firm should consider updating its audit programs to include required documentation procedures when communicating reportable conditions.

66. **Finding**—The firm's quality control policies and procedures require completion of a reporting and disclosure checklist and a partner review of the firm's reports and accompanying financial statements prior to issuance. However, on several engagements reviewed, we noted inappropriate answers on these checklists. As a result, several financial statements did not include all the disclosures required by generally accepted accounting principles. None of the missing disclosures were of such significance as to make the financial statements misleading.

Recommendation for Improvement—The firm should reemphasize the importance of using its comprehensive financial statement reporting and disclosure checklists. The partners of the firm should carefully review the report and disclosure checklist as part of the final financial statement review. In addition, a training session should be held to review with the staff the questions on the financial statement reporting and disclosure checklist. The firm should emphasize this item in its next inspection.

- .67 **Finding**—The firm's policies and procedures require the completion of a reporting and disclosure checklist and a comprehensive supervisory review by engagement personnel on all accounting and auditing engagements. Our review noted that certain checklists were improperly completed which resulted in omitted or inadequate disclosures on financial statements in such areas as concentrations of credit risk and related party transactions. None of these deficiencies were of such significance to make the financial statements misleading.

Recommendation—The firm should reemphasize its quality control policies for proper completion and review of reporting and disclosure checklists to provide assurance of compliance with professional standards. Additional staff training should be taken in financial statement and disclosure areas.

Hiring

Quality Control Objective

- .68 Statement on Quality Control Standards No. 1 states that—

Policies and procedures for hiring should be established to provide the firm with reasonable assurance that those employed possess the appropriate characteristics to enable them to perform competently. The quality of a firm's work ultimately depends on the integrity, competence, and motivation of personnel who

perform and supervise the work. Thus, a firm's recruiting programs are factors in maintaining such quality.⁹

Illustrative Example of Design Deficiencies

- .69 **Finding**—The firm's policies and procedures require that new hires possess certain specified qualifications. However, the policies do not require that the firm document its hiring decisions and the basis thereof. As a result, the personnel files did not always contain sufficient evidence confirming that the individuals hired possess the required qualifications. During our review of engagements, nothing came to our attention to indicate that the individuals hired by the firm did not possess the required qualifications.¹⁰

Recommendation for Improvement—We recommend that the firm revise its policies and procedures to require that hiring decisions be documented. The nature of the documentation may vary; however, at a minimum, it should document whether an individual meets the stated qualifications and, if not, why it is acceptable to deviate from the firm's stated hiring criteria in the situation.

Illustrative Example of Compliance Deficiencies

- .70 **Finding**—The firm's policies require that certain background information be obtained relative to the qualifications of prospective employees (including resumes, applications, college transcripts, and references). During our review, we noted numerous instances in which the personnel files for professional staff hired other than through the firm's college campus recruiting program did not contain evidence that the individual met the firm's stated qualifications.¹⁰

Recommendation for Improvement—We recommend that the firm take greater care in ensuring that it complies more fully with its policies. The firm should assign an individual with appropriate experience to monitor the firm's compliance with its policy of obtaining background information on prospective employees.

⁹ Ibid., footnote 5.

¹⁰ This example may not be applicable for smaller firms that have ongoing monitoring and involvement of senior personnel of the firm with respect to this element of quality control.

Professional Development

Quality Control Objective

.71 Statement on Quality Control Standards No. 1 states that—

Policies and procedures for professional development should be established to provide the firm with reasonable assurance that personnel will have the knowledge required to enable them to fulfill responsibilities assigned. Continuing professional education and training activities enable a firm to provide personnel with the knowledge required to fulfill responsibilities assigned to them and to progress within the firm.¹¹

Illustrative Examples of Design Deficiencies

.72 **Finding**—Although the firm's personnel were in compliance with the firm and the section's continuing professional education requirement, an inadequate amount of the courses taken were in accounting and auditing related areas. As a consequence, we encountered instances in which emerging issues and matters relating to recent professional pronouncements had not been considered on engagements. In one such instance, the report was recalled and the accompanying financial statements were restated.

Recommendation for Improvement—The firm's policies and procedures should be revised to include a requirement that personnel participate in an appropriate amount of continuing professional education in accounting and auditing areas.

.73 **Finding**—The firm's policies and procedures require that professional staff participate in at least forty hours of continuing professional education courses and that the administrative partner compile, at the end of each educational year, a summary of professional education courses in which the professional staff participated. The policies and procedures do not require that the files be maintained during the period or that the files be reviewed periodically to

¹¹ AICPA Professional Standards, Vol. 2, QC §10.07.

determine whether the staff is in compliance with the firm's requirements. During our review, we noted a few individuals who had not participated in the required amount of continuing professional education courses during the year under review and were unable to make up the deficiency during the two-month grace period that followed the education year-end.

Recommendation for Improvement—We recommend that the firm revise its quality control policies and procedures to require that the administrative partner maintain current professional development records and that he review these periodically to determine whether the professional staff are complying with the firm's policies in this area.

- .74 **Finding**—The firm's policies and procedures require that the firm maintain formal professional development records documenting each professional education course in which the professional staff participated. However, the policies and procedures do not specify the nature or extent of these records. Consequently, we noted incomplete documentation in the continuing professional education records, even though we were satisfied that the staff had participated in a sufficient amount of continuing professional education.

Recommendation for Improvement—We recommend that the firm's policies and procedures be revised to require that records be maintained for each professional in the firm for the five most recent educational years. Furthermore, the policies should require that the following information be maintained relative to each continuing professional education activity for which credit is claimed:

- Sponsoring organization
- Location of program by city and state
- Title of program and/or description of content
- Dates attended or completed
- Continuing professional education hours claimed

- .75 **Finding**—The firm's policies and procedures require that professional staff participating in governmental engagements meet the continuing education requirements established both by the section and Government Auditing Standards. However, we noted that the firm has not specifically identified these staff members and monitored their compliance with government auditing standards. As a result, we noted several individuals who had not completed sufficient professional education courses to comply with government auditing standards.

Recommendation for Improvement—The firm's professional education director should identify and monitor those individuals

participating in governmental engagements to ensure that the government auditing standards continuing professional education requirements are met.

- .76 **Finding**—The firm's policies and procedures require all firm personnel to meet the professional development requirements of both their state board of accountancy and the American Institute of Certified Public Accountants. While firm personnel met these requirements, the courses taken did not provide firm personnel with sufficient information about current developments in accounting and auditing matters. As a result, our review discovered that firm personnel were not aware of recent pronouncements and new disclosure requirements and had not made necessary disclosures in financial statements in such areas as concentrations of credit risk and income taxes. None of the missing disclosures were of such significance to make the financial statements misleading.

Recommendation—The firm should revise its quality control policies to require firm personnel to participate in an appropriate amount of accounting and auditing continuing professional education in the industry areas in which the firm practices.

Illustrative Examples of Compliance Deficiencies

- .77 **Finding**—Our review disclosed that professional staff had not received copies of certain professional pronouncements issued during the past year as required by firm policy. During our review, we did not note any significant departures from professional standards as a result of this deficiency.

Recommendation for Improvement—In order to keep professional staff current on financial accounting, auditing and reporting matters, we recommend that all professional staff receive copies of professional pronouncements as soon as they are available to the firm for distribution.

Advancement

Quality Control Objective

- .78 Statement on Quality Control Standards No. 1 states that—

Policies and procedures for advancing personnel should be established to provide the firm with reasonable assurance that those selected for advancement will have the qualifications necessary for fulfillment of the responsibilities they will be called on to assume. Practices in advancing personnel have important impli-

cations for the quality of a firm's work. Qualifications that personnel selected for advancement should possess include, but are not limited to, character, intelligence, judgment, and motivation.¹²

Illustrative Example of Design Deficiencies

- .79 **Finding**—The firm has not established policies and procedures regarding the qualifications necessary for each level of responsibility within the firm and for the advancement of personnel. However, we did not encounter any situation where the firm's personnel did not have the qualifications necessary to fulfill their responsibilities.¹³

Recommendation for Improvement—We recommend that the firm establish and document the qualifications necessary for each level of responsibility and create a review structure to ascertain that personnel meet the firm's requirements before they are promoted.

Illustrative Example of Compliance Deficiencies

- .80 **Finding**—The firm's policies and procedures require that personnel be evaluated by their immediate supervisor whenever they participate forty hours or more on an engagement. Our review of the personnel files indicates that this policy is not always being adhered to for management level personnel, even though overall annual evaluations are being performed.¹⁴

Recommendation for Improvement—Because it is important that all personnel, regardless of level, be provided with constructive recommendations for improvements in their performance so that they can implement timely corrective actions and, thus, progress within the firm, we believe that the firm should comply with its policy more fully.

¹² Ibid., footnote 11.

¹³ See footnote 10.

¹⁴ See footnote 10.

Acceptance and Continuance of Clients

Quality Control Objective

.81 Statement on Quality Control Standards No. 1 states that—

Policies and procedures should be established for deciding whether to accept or continue a client in order to minimize the likelihood of association with a client whose management lacks integrity. Suggesting that there should be procedures for this purpose does not imply that a firm vouches for the integrity or reliability of a client, nor does it imply that a firm has a duty to anyone but itself with respect to the acceptance, rejection, or retention of clients. However, prudence suggests that a firm be selective in determining its professional relationships.¹⁵

Illustrative Examples of Design Deficiencies

.82 **Finding**—The firm's policies and procedures do not require communication with the predecessor auditor of a prospective client as required by professional standards. During our review, we noted an instance where there was no documentation of communication with a predecessor auditor. However, we were informed by the firm's personnel that the required communication had been made orally.

Recommendation for Improvement—The firm should revise its quality control document to require communication with predecessor auditors and to require that such communications be documented.

.83 **Finding**—The firm's quality control policies and procedures require evaluation of prospective clients for approval prior to acceptance as clients, and for the periodic evaluation of all clients to ensure that the firm's criteria for client continuance are met. However, the firm does not require any specific documentation of such evaluations and we noted no documented evidence that evaluations had been performed. We were informed by the firm's partners that they had complied with their policies and procedures, but had not documented this information.

¹⁵ AICPA Professional Standards, Vol. 2, QC §10.07.

Recommendation for Improvement—The firm's quality control policies and procedures should be revised to require documentation of its acceptance and continuance procedures and decisions. The firm should revise and implement client acceptance and continuance forms to ensure that all appropriate factors are considered in each case.

Illustrative Examples of Compliance Deficiencies

- .84 **Finding**—The firm's quality control policies and procedures specify criteria that should be considered when making client continuance decisions and requires that such decisions be documented. During our review, we were unable to determine whether client continuance decisions had been made in accordance with the firm's policies. However, we were informed by the firm's partners that continuance decisions are discussed informally and that continuance is assumed by staff in the absence of instructions to discontinue service to the client.

Recommendation for Improvement—The firm should comply with its policies and procedures by periodically evaluating its existing clients in accordance with the criteria set forth in its quality control document. The firm should also document such evaluations and decisions as required by firm policy, possibly through the use of a standardized form that could be examined as part of the planning process.

- .85 **Finding**—The firm's quality control policies and procedures regarding new client acceptance require the preparation and approval of a new client acceptance form to document the considerations and conclusions. During our review, we noted that the form was not prepared for all new clients. However, we were informed by the firm's partners that appropriate considerations had been made in each case.

Recommendation for Improvement—To ensure that all appropriate facts are considered when accepting a new client, the firm should comply with its policy of documenting its considerations and conclusions by completing the new client acceptance form for each new client.

Inspection

Quality Control Objective

- .86 Statement on Quality Control Standards No. 1 states that—
Policies and procedures for inspection should be established to provide the firm with reasonable

assurance that the procedures relating to the other elements of quality control are being effectively applied. Procedures for inspection may be developed and performed by individuals acting on behalf of the firm's management. The type of inspection procedures used will depend on the controls established by the firm and the assignment of responsibilities within the firm to implement its quality control policies and procedures.¹⁶

Illustrative Examples of Design Deficiencies

- .87 **Finding**—The firm's quality control policies and procedures do not require that a formal annual inspection program be performed. However, the firm does require pre-issuance reviews of each audit review and compilation report, the accompanying financial statements and the related working papers by both the engagement partner and a partner or manager who is not otherwise associated with the engagement. The firm's procedures do not require an annual review of the firm's compliance with each element of quality control, nor do they require a written summary of deficiencies identified or corrective actions taken or planned to be taken.

Recommendation for Improvement—The firm should revise its quality control policies and procedures to require that a formal annual inspection be performed. The firm's inspections should address each of the elements of quality control in addition to engagements. The quality control policies and procedures should also require the preparation of written inspection reports that summarize the deficiencies identified and document the actions taken or planned to prevent similar deficiencies from occurring in the future.

- .88 **Finding**—The firm's inspection policies and procedures omit specialized industry knowledge as criteria in selecting inspectors. As a result, a manager reviewed several engagements in a specialized industry with which he had little knowledge and failed to identify several omitted procedures. Our review of engagements in this industry, however, did not disclose any significant departures from professional standards.

¹⁶ Ibid., footnote 15.

Recommendation for Improvement—The firm should revise its quality control policies and procedures to include technical expertise and relevant specialized industry knowledge as a criteria in selecting inspectors. In doing so, the firm can implement appropriate corrective actions for inspection findings.

89. **Finding**—The firm's inspection policies and procedures do not require the preparation of memoranda summarizing the results of the firm's annual inspection program and the implementation of corrective actions. As a result, the firm did not document its monitoring of the actions taken in response to the inspection findings.

Recommendation for Improvement—The firm should revise its quality control policies and procedures to require the preparation of an inspection memorandum summarizing findings, indicating recommended corrective actions, and setting time-tables for completing the corrective actions. At a minimum, the memorandum should be distributed to key management personnel.

Illustrative Examples of Compliance Deficiencies

- .90 **Finding**—The firm's policies and procedures require that findings on engagement reviews 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 partner considered and responded to findings on their individual engagements.

Recommendation for Improvement—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.

- .91 **Finding**—The firm's quality control document requires that annual inspections be performed in accordance with the AICPA's "Guidelines on How to Perform an Internal Inspection." In the most recent inspection, however, the firm did not review certain elements of quality control.

Recommendation for Improvement—The firm should comply with its quality control policies and procedures by using all of the recommended forms in the AICPA's "Guidelines on How to Perform an Internal Inspection." The use of these forms should result in the performance of all the required inspection procedures, including the review of all of the functional areas of quality control.

- .92 **Finding**—The firm's quality control policies and procedures require timely annual inspections. Our review revealed that the reports on the past two inspections were dated almost one year after the particular inspection year-end. As a result, the firm did not implement the recommended corrective actions prior to beginning subsequent engagements.

Recommendation for Improvement—To maximize the benefits that can be gained from a timely inspection, the firm should perform its inspections in a timely manner so that corrective actions can be implemented before procedures and engagements are performed in the subsequent year.

- .93 **Finding**—The firm has a written quality control document that requires the firm to perform annual internal inspections. However, during our review, we noted that the firm did not perform annual inspections as required. If an adequate and timely inspection had been performed each year, many of the departures from professional standards that were noted during our review probably would have been identified and corrected.

Recommendation for Improvement—The firm should comply with its quality control policies and procedures regarding inspection.

Membership Requirements

PCPS AND SECPS MEMBERSHIP REQUIREMENTS

- .94 **Finding**—The firm's policies and procedures require that each professional in the firm participate in at least 120 hours of continuing professional education every three years, but not less than 20 hours each year. Our review disclosed that, for the period ended June 30, 19XX, several of the firm's management personnel failed to comply with the three-year requirement.

Recommendation for Improvement—The firm should establish procedures to monitor compliance, on a timely basis, with the section's continuing education requirements.

- .95 **Finding**—The section requires that all professional staff, including CPAs and non-CPAs, participate in at least 120 hours of continuing professional education every three years with a minimum of 20 hours per year. The firm's policy is not consistent with this requirement, since its policy states that only CPAs are required to participate in the hours prescribed by the section. As a result, a significant number of professionals did not comply with the section's membership requirements since the firm did not monitor compliance by professionals who are not CPAs.

Recommendation for Improvement—The firm should expand its continuing professional education requirements to encompass both CPAs and other professionals.

- .96 **Finding**—The firm's quality control policies and procedures are not consistent with the section's membership requirements which require each member firm to ensure that a majority of the members of the firm are CPAs, and that the firm can legally engage in the practice of public accounting. Although the firm is qualified to practice under state law, only one of the partners is a CPA. This does not meet the majority requirement.

Recommendation for Improvement—The firm should revise its policies and procedures to ensure compliance with all membership requirements. In addition, the firm should take steps necessary to be in compliance with this membership requirement as soon as possible.

SECPS MEMBERSHIP REQUIREMENTS

- .97 **Finding**—The section's membership requirements require that each member firm establish policies and procedures for a concurring review of the report and financial statements by a partner other than the audit partner-in-charge of an SEC engagement before the issuance of an audit report on the financial statements of an SEC engagement. These policies and procedures should cover such areas as (1) qualifications of the concurring reviewer, (2) nature, extent, and timing of the review, and (3) documentation required evidencing that the reviewer had complied with the firm's policies and procedures for the concurring review. During our review of the working papers on these types of clients, we found inconsistency in the extent of the review and in the types of documentation contained in the working papers. However, we were satisfied that a comprehensive review was performed by qualified individuals.

Recommendation for Improvement—We recommend that the firm's quality control policies and procedures be revised to include specific requirements regarding concurring review including the nature and extent of the review and the types of documentation required. This may include the implementation of a concurring reviewers' checklist and/or a requirement that the reviewer initial all memoranda and selected working papers, in addition to the report and financial statements.

.98 APPENDIX A – Sample Letter of Comments For The Peer Review Programs

[AICPA or Other Appropriate Letterhead]

September 15, 19__

[Should correspond with date of report]

To the Partners
Jones, Smith & Co.

We have reviewed the system of quality control for the accounting and auditing practice of Jones, Smith & Co. (the firm) in effect for the year ended June 30, 19__, and have issued our report thereon dated September 15, 19__ (which was modified as described therein).^{*} This letter should be read in conjunction with that report.

Our review was for the purpose of reporting upon your system of quality control and your compliance with it and with the membership requirements of the (private companies practice section or SEC practice section) of the AICPA Division for CPA Firms (the section). Our review was performed in accordance with the standards promulgated by the peer review committee of the section; however, our review would not necessarily disclose all weaknesses in the system or lack of compliance with it or 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 procedures may deteriorate.

* To be included if the review team issues a modified or adverse report. The wording should be tailored to fit the circumstances.

Matters That Resulted in a Modified Report****Supervision**

Finding—Our review disclosed that the firm's quality control policies and procedures do not provide a means of ensuring that the financial statements reported on include all relevant disclosures. As a result, we noted financial statements that did not include all of the disclosures required by generally accepted accounting principles, and in one instance, financial statements that were materially misstated. The report on the latter financial statements has been recalled, and the financial statements are being revised.

Recommendation for Improvement—The firm should adopt procedures to ensure that clients' financial statements include all relevant disclosures, such as by obtaining or developing comprehensive financial statement disclosure and reporting checklists.

Consultation

Finding—Our review disclosed that the firm's quality control policies and procedures for consultation with designated parties outside the firm were not followed on two engagements. One engagement, discussed above, involved a material error in a financial statement, on which the firm had issued an unqualified report. On the other engagement, the firm had issued an unqualified audit report when it was not independent. In both cases, we concluded that adherence to the firm's consultation policies and procedures probably would have prevented the issuance of these reports, which the firm has since recalled.

Recommendation for Improvement—The firm should (1) reemphasize the importance of its quality control policies and procedures for outside consultation, (2) more closely monitor compliance with its consultation policies and procedures during the preissuance review of engagements, and (3) emphasize these policies and procedures in its next inspection.

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

Matters That Did Not Result in a Modified Report**

Client Acceptance

Finding—The firm's quality control policies and procedures require that the managing partner approve the acceptance of new clients and document such approval. We noted several instances where this had not been done. The letter of comments issued in connection with the firm's prior peer review also noted that this policy had not been followed in a number of instances.

Recommendation for Improvement—We recommend that the firm revise its new client information form, as it indicated it would in its prior letter of response, to provide an appropriate place for the managing partner's signature evidencing approval. In addition, an account number should not be assigned to a new client until this form has been completed.

Independence

Finding—The firm's quality control policies and procedures require appropriate evaluation and resolution of all questions regarding independence. However, the firm does not require any specific documentation of such resolutions. We noted that there was no documentation supporting such resolutions.

Recommendation for Improvement—We recommend that the firm amend its quality control policies and procedures to require documentation of the resolution of independence questions.

Supervision

Finding—Our review disclosed that on several audit engagements the firm's standard programs for testing related-party transaction and subsequent events were not used as required by firm policy. However, we were able to satisfy ourselves that sufficient audit procedures had been performed in these areas.

Recommendation for Improvement—The firm should reemphasize its policy of using the standard programs as required by its auditing and accounting manual.

Finding—The firm's quality control policies and procedures require the use of standard audit and work programs. However, in one recently acquired office of the firm, representing a small portion

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

of the firm's practice, the firm's standard audit and work programs have not been used consistently.

Recommendation for Improvement—The firm should reemphasize the need to comply with its policies and procedures. In addition, a partner from another office should be assigned the responsibility for training personnel of the acquired office in the use of the firm's standard programs.

Continuing Professional Education

Finding—The firm's quality control policies, and the membership requirements of the section, require each professional to obtain at least 20 hours of continuing education annually and at least 120 hours every three years. However, the firm does not have adequate procedures to monitor compliance with this policy. As a result, our review disclosed that five of the firm's sixty professionals had not participated in the required number of hours of qualifying continuing education.

Recommendation for Improvement—The firm should make sure that the five professionals referred to above obtain a sufficient number of continuing education hours to meet the section's annual and three-year requirements for its current educational year.

The foregoing matters were considered in determining our opinion set forth in our report dated September 15, 19__, and this letter does not change that report.

William Brown
Team Captain

[for review by a
committee-appointed
review team]

or

Johnson & Co.

[for review by
a firm]

or

William Brown
Team Captain

[for review by
an association
or state CPA
society-sponsored
review team]

.99 APPENDIX B – Sample Letter of Comments For The Quality Review Program

[AICPA or Other Appropriate Letterhead]

September 15, 19__

[Should correspond with date of report]

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

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

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

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

Matters That Resulted in a Modified Report*

Finding—The firm's quality control policies and procedures do not require partner involvement in the planning stage of audit engagements. Generally accepted auditing standards permit the auditor

* Include these captions only when the report is modified.

with final responsibility for the engagement to delegate some of this work to assistants, but emphasize the importance of proper planning to the conduct of the engagement. We found one engagement in which, as a result of a lack of involvement, including timely supervision, by the engagement partner in planning the audit, the work performed on receivables and inventory did not appear to support the firm's opinion on the financial statements. (As a result of this finding, the firm performed the necessary additional procedures to provide a satisfactory basis for its opinion.)

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

Matters That Did Not Result in a Modified Report*

Finding—Our review disclosed several engagements for which financial statement disclosures were missing or incomplete. None of the missing or incomplete disclosures represented significant departures from professional standards, but in each case we noted that the firm had not complied with its policy requiring completion of a financial reporting and disclosure checklist.

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

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

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

* Include these captions only when the report is modified.

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.

<hr/> William Brown Team Captain	[for review by a committee-appointed review team]
	or
Johnson & Co.	[for review by a firm]
	or
<hr/> William Brown Team Captain	[for review by an association or state CPA society-sponsored review team]

.100 APPENDIX C—Checklist for Reviewing Drafts of Letters of Comments

	<u>Yes</u>	<u>No*</u>
1. Do the first three and last paragraphs of the letter of comments (LOC) conform with the standard LOC included in the applicable standards?	_____	_____
2. If the report is qualified, is the first section of the report entitled "Matters that Resulted in a Modified (Adverse) Report?"	_____	_____
3. Are headings included for each quality control element on which there is a comment?	_____	_____
4. Is each finding and recommendation clearly captioned?	_____	_____
5. Are findings written with a systems orientation?	_____	_____
6. Are findings caused by the same quality control deficiency grouped into a single comment?	_____	_____
7. Are general terms used to indicate frequency of occurrence rather than specific numbers?	_____	_____
8. Have you avoided identifying, by name or otherwise, specific engagements, individuals, or offices?	_____	_____
9. Are comments written in a succinct, but complete manner (without excessive details)?	_____	_____
10. Are the findings clearly understandable to someone not familiar with the specific engagement and functional area findings?	_____	_____

* All no answers should be resolved before the letter of comments is finalized.

	<u>Yes</u>	<u>No*</u>
11. Are findings written in a specific enough manner so that the comment will not automatically be repeated on the next review?	___	___
12. Have personal preference items been excluded from the letter?	___	___
13. Is the letter of comments free of all references to specific technical standards?	___	___
14. Have third-party practice aids been referred to in general terms?	___	___
15. Has the "loop been closed" in all cases in which performance deficiencies are mentioned?	___	___
16. Are repeat comments clearly identified?	___	___

* All no answers should be resolved before the letter of comments is finalized.

.101 APPENDIX D – Examples of Poorly Written Letter of Comments Items

This appendix contains illustrative examples of poorly written items included in letters of comments. Each example includes a critique of the deficiencies noted. Reviewers should focus on the points included in the critiques. It is important to remember that a well-written letter of comments enhances the peer or quality review documents.

.102 Example 1:

In one audit engagement, the firm's files did not contain a letter from the client's attorney as to litigation, etc. In another engagement, attorney responses were dated several weeks prior to the date of the auditor's report.

The firm should add a step to its audit programs to require documentation of the procedures performed to obtain updated responses to attorney letter replies received prior to the end of field work.

Critique of Example 1:

- The finding does not indicate what the firm's quality control policies and procedures do or do not require regarding the obtaining of letters of inquiry from a client's attorney. Further, the finding does not describe the implications of the deficiencies noted.
- The finding is written in an engagement-oriented format rather than a systems-oriented format. As described in the guidance material, the letter of comments should include comments regarding the design of the reviewed firm's system of quality control or its compliance with that system.
- The finding cites the exact number of instances noted rather than using general terms to indicate frequency, such as "in some instances," "frequently," or "an isolated case."
- The example does not include captions highlighting the findings and recommendations.

Suggested Wording for Example 1:

Finding—The firm's quality control policies and procedures require obtaining letters of inquiry from a client's attorney for all audit engagements. However, we noted instances where the attorney's letters had not been obtained or were dated several weeks prior to the auditor's report. Subsequent to our review, the firm has requested and received the missing attorney letters and received updated responses for the attorney letters that were dated prior to the date of the auditor's report.

Recommendation for Improvement—The firm should reemphasize the importance of complying with its policy of obtaining attorney letters for all auditing engagements. In addition, during their review of engagement working papers, supervisory personnel should ensure that attorney letters are dated as close to the completion of fieldwork as is practicable in the circumstances. The partners of the firm should ensure that these documents are reviewed as part of their review of working papers.

.103 **Example 2:**

In a few instances, the financial statements did not disclose the carrying basis of property, plant and equipment and whether or not any of the assets were donated.

Critique of Example 2:

- The finding does not have a recommendation.
- The finding does not indicate the effect on the financial statements, if any, as a result of the deficiencies noted, and it is not clear why the finding is important.
- The finding does not indicate the likely cause of the deficiency (for example, inadequate financial statement disclosure and reporting checklist or lack of appropriate partner review).

Suggested Wording for Example 2:

Finding—The firm's quality control policies and procedures require the completion of a reporting and disclosure checklist for all audit engagements. However, on several engagements reviewed the financial statements did not include all the disclosures required by generally accepted accounting principles. None of the missing disclosures were of enough significance to make the financial statements misleading.

Recommendation for Improvement—The firm should reemphasize the importance of thoroughly completing its comprehensive financial statement reporting and disclosure checklists. The partners should carefully review the report and disclosure checklist as part of the final financial statement review.

.104 **Example 3:**

Finding—Every engagement we reviewed was determined to be in compliance in all material respects with professional standards. However, in a number of engagements reviewed, there were inadequate disclosures regarding related party matters.

Recommendation for Improvement—All material related party transactions should be disclosed in the financial statements as required by FASB Statement No. 57.

Critique of Example 3:

- The finding and recommendation do not indicate what the systems implications of the deficiency are. Why were the disclosures inadequate? Were firm policies followed?
- Generally, a finding should include a conclusion as to the effect, if any, the deficiencies had on the financial statements reviewed.
- Recommendations that essentially say "follow professional standards," as in the example, are not helpful to the firm. Instead, recommendations should address the underlying cause of the deficiency.
- The recommendation refers to a specific technical pronouncement without a clear indication of the nature of the standard.

Suggested Wording for Example 3:

Finding—The firm's policies and procedures require the completion of financial statement disclosure checklists for all audit, review and full disclosure compilation engagements. However, our review disclosed several instances where the financial statements did not include all the disclosures required by generally accepted accounting principles, particularly in the area of related party matters. The incomplete disclosures were not of such significance as to make the financial statements misleading.

Recommendation for Improvement—The firm should reemphasize its policy of using disclosure checklists on all full disclosure engagements. The partners should carefully review the disclosure checklist as part of the final financial statement review. In addition, a training session should be held to review with staff the disclosure requirements for related party transactions.

.105 **Example 4:**

Finding—The firm's procedural documents do not provide guidance with respect to audit sampling procedures, or analytical review procedures.

Recommendation for Improvement—The firm should include, in its accounting manual, guidance on audit sampling procedures and analytical review procedures.

Critique of Example 4:

- The finding does not describe the engagement deficiencies, if any, resulting from this design deficiency.

Suggested Wording for Example 4:

Finding—The firm's quality control policies and procedures provide for audit sampling procedures and analytical review procedures. However, the firm has not established procedures for performing or the documentation required for these areas. As a result, we noted instances where the firm performed non-statistical sampling, but did not document its considerations. In addition, on several engagements reviewed, there was no documentation of analytical review procedures. Through discussions with firm personnel, we were able to satisfy ourselves that adequate procedures had been performed.

Recommendation for Improvement—The firm should revise its policies and procedures to require documentation of sample selections and evaluation of sampling results. This can be accomplished by obtaining or developing a standardized form that conforms to the guidance included in professional standards. In addition, the firm should revise its policies to require specific analytical review procedures and the documentation of such procedures.

.106 Example 5:

Finding—The firm does not use planning programs and, as a result, planning procedures are not always fully documented in engagement working papers. On certain of the engagements reviewed, there was no documentation of the planning aspects relative to preliminary judgments about materiality levels for audit purposes, assessed level of control risk, and other audit planning considerations.

Recommendation for Improvement—The firm should develop or obtain a planning program for use on each engagement.

Critique of Example 5:

- The finding does not indicate what the system does nor does not require regarding audit planning. Also, the finding does not indicate whether the reviewer believes sufficient planning procedures were performed on the engagements reviewed.
- A recommendation for a "canned" program or checklist is not particularly helpful as it is too specific. Rather, the recommendation should indicate that the firm should establish policies or procedures to ensure that planning considerations are documented, such as by developing or obtaining a planning checklist that deals with the areas cited. The recommendation might also note that proper planning may reduce audit time overall.

Suggested Wording for Example 5:

Finding—The firm's quality control policies and procedures require documentation of audit planning considerations. The firm does not require the use of planning programs, checklists or other appropriate means of documenting such planning considerations. During our review, we noted there was no documentation of the planning aspects relative to preliminary judgments about materiality levels for audit purposes, assessed level of control risk, and other planning considerations. However, we were able to satisfy ourselves that, in each case, these areas were appropriately considered in determining the nature and extent of auditing procedures.

Recommendation for Improvement—The firm should establish policies and procedures to ensure that planning considerations are documented, such as by obtaining or developing a planning checklist for use on audit engagements.

.107 **Example 6:**

Finding—The firm's quality control policies and procedures require all working papers to be reviewed by someone at a higher, or at least the same, level.

Recommendation for Improvement—The firm should reemphasize to its professional personnel the importance of reviews. This requirement could be added to the partner's review checklists to ensure compliance.

Critique of Example 6:

- The finding does not indicate that the firm did not comply with its policy and, if not, whether this resulted in any engagement deficiencies.

Suggested Wording for Example 6:

Finding—On several of the engagements reviewed, we noted that a review by a partner having no other responsibility for the engagement had not been performed as required by firm policy. On these engagements, we noticed that several disclosures required by generally accepted accounting principles were omitted from the financial statements. However, none of the missing disclosures were of such significance to make financial statements misleading.

Recommendation for Improvement—The firm should comply with its policy of having a second partner review each engagement. To ensure compliance with this policy, the firm should require that the second partner initial the report control sheet before the report is issued.

.108 **APPENDIX E – Guidance for Determining Whether A Finding Appeared in the Letter Issued In Connection With a Prior Peer or Quality Review**

Paragraph 2200.24(o) indicates—

If any of the matters to be included in the letter of comments were included in the letter issued in connection with the firm's previous peer or quality review, this fact ordinarily should be noted in describing the matter.

A finding would be considered a repeat finding if the deficiencies noted during the current review are caused by the same quality control system's weakness noted in the letter issued in connection with the reviewed firm's prior peer or quality review. To determine whether a finding is a repeat finding, the team captain should read the prior letter of comments and letter of response and evaluate whether the actions outlined in the response have been implemented as promised. If the promised actions have been implemented and the same engagement deficiencies are occurring (such as incomplete or omitted disclosure deficiencies), the team captain should, with the reviewed firm's assistance, determine the weakness in the firm's quality control system which could be causing the deficiencies to continue to occur.

.109 **Example 1:**

This finding was included in the firm's previous review.

Prior Finding—The firm's quality control policies and procedures require the firm to complete a reporting and disclosure checklist on all engagements. Our review discovered that these checklists were not completed on all engagements. Disclosure deficiencies were noted in such areas as related party transactions and lease commitments. None of these disclosures were considered significant departures from professional standards.

Prior Recommendation—The firm should reemphasize its policies regarding the completion of a comprehensive disclosure checklist on all accounting and auditing engagements. These checklists should be completed by a member of the engagement team, reviewed by the engagement partner, and retained with the engagement working papers.

Prior Response—The firm has reemphasize its policies regarding the completion of a comprehensive disclosure

checklist on all accounting and auditing engagements. These checklists should be completed by a member of the engagement team, reviewed by the engagement partner, and retained with the engagement working papers.

Results on Current Review

In the performance of the current year's review, the team captain noted the firm personnel are completing a disclosure and reporting checklist on all accounting and auditing engagements. However, some disclosure deficiencies are still noted in the areas of deferred taxes and concentration of credit risk.

Comparison of Prior and Current Deficiencies

In this example, the firm took its commitment seriously and reinforced its policy on the use of a disclosure checklist as promised. Therefore, the team captain must look for other weaknesses in the firm's quality control system which could be causing the disclosure deficiencies to continue to occur.

The team captain noted that concentration of credit risk was covered by a recent pronouncement and that deferred taxes was a complex area that often requires special training. Upon further investigation, the team captain also found that the firm has taken the continuing education required by the state board of accountancy and the AICPA, but most of the classes did not relate to accounting and auditing. Therefore, the team captain concluded the cause of the disclosure deficiencies is a weakness in the firm's professional development policies because those policies do not require that sufficient education be taken on new accounting pronouncements and on specialized areas. Since this was not noted in the prior review, the finding in the current review would not be considered a repeat finding.

.110 **Example 2:**

This finding was included in the firm's previous review.

Prior Finding—The firm's policies and procedures require consultation in situations that involve complex subject matters or newly issued technical pronouncements. During our review, we noted several instances where the firm researched the issues encountered but failed to consult with the individual designated in the quality control document. The firm issued several reports for a governmental entity, but did not include all required wording to comply with professional standards. The

Standards for Performing and Reporting on Peer Reviews

reporting deficiencies were not of such significance to make the auditor's report misleading.

Prior Recommendation—The firm should reemphasize its policies regarding consultation as outlined in its quality control document. The firm should encourage its staff to consult with or use authoritative sources on complex or unusual matters.

Prior Response—In a meeting held on October 15, 19XX, we reviewed our policies regarding consultation with all of our accounting and auditing staff and encouraged the staff to consult with or use authoritative sources on complex or unusual matters.

Results on Current Review

In the performance of the current year's review, the review team confirmed that the meeting of October 15 took place and that the firm's consultation policies were reviewed at that meeting. However, the review team also found that issues requiring consultation, such as a change in the method of recording inventory and a pooling of interests, were not reported appropriately.

Comparison of Prior and Current Deficiencies

Upon further research, the team captain discovered that the staff members researched these issues internally, but failed to consult with the partner designated as the consultant for the issues involved as required under the firm's quality control system. Since the current engagement deficiencies are caused by the same weakness in the firm's quality control system noted in the prior review, this finding would be considered a repeat finding in the current review.

SUGGESTIONS FOR WRITING A RESPONSE TO A LETTER OF COMMENTS

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Suggestions for Writing a Response to a Letter of Comments

Peer Review Standards

- .01 Upon completion of the peer review, the review team will communicate its findings to a reviewed firm through an exit conference. The team captain ordinarily will issue a written report and a letter of comments, if any, within thirty days of the firm-wide exit conference. Within thirty days of the issuance of these documents, the reviewed firm is required to submit to the peer review committee a copy of the report, the letter of comments, and a written response to the matters contained in that letter.

Contents of the Response

- .02 The response should be addressed to the peer review committee and should describe the actions taken or planned with respect to each matter in the letter. Depending on the circumstances, the firm might in responding—
- a. Agree entirely with a finding and the need to implement the recommended action.
 - b. Agree entirely with a finding, but believe that an alternative action is more appropriate than the one recommended.
 - c. Agree entirely with a finding, but disagree with the need to implement any corrective action.
 - d. Disagree with a finding in some respect, and agree with the need to implement the recommended action.
 - e. Disagree with a finding in some respect, but believe that an alternative action is more appropriate than the one recommended.
 - f. Disagree entirely with a finding and the recommended action.
- .03 If the firm disagrees with either a finding or the recommended corrective action, its letter of response should describe the basis and rationale for the disagreement.

Note: This section summarizes the descriptions pertaining to letters of response and the peer review committees' consideration of peer review reports discussed in PCPS §2000.114-.124.

- .04 Appendix A, PCPS §2300.09, illustrates how a firm might respond to a letter of comments.

Committee Consideration of Peer Review Documents

- .05 A report on a peer review is sent to the section's peer review committee (the committee), together with the letter of comments, if any, and the reviewed firm's response to the letter. Upon acceptance by the committee, the firm will be notified in writing and the documents will be placed in the public files of the Division for CPA Firms.
- .06 Prior to acceptance, the staff of the AICPA quality review division (the staff) will review the aforementioned peer review documents and all or some of the review team's working papers. The staff will evaluate whether the findings appear to be properly reported upon and report its conclusions to the committee. The committee also will review the peer review documents and consider the comments of the staff. During its review, the committee will decide whether—
- a. The peer review has been performed and reported upon in accordance with the peer review standards.
 - b. The reviewed firm or the committee need to take any additional actions.
- .07 Several factors influence the committee's decisions on the second item. The factors include the committee's judgment regarding—
- a. The nature and significance of the matters in the letter of comments.
 - b. Whether the reviewed firm's response presents either a satisfactory course of action or convinces the committee that additional action is unnecessary.
 - c. Whether the reviewed firm's response to a matter appears to be an arbitrary rejection of the comment or an inappropriate conclusion not to take suitable action.
- .08 The committee will then decide whether to accept a report, letter of comments, and letter of response. In some cases, a review team captain may be asked to revise the report or letter of comments or a firm may be asked to revise its response in whole or in part or to agree to take certain additional actions. When additional actions are required, they may include—

- a. Obtaining documentary evidence that the matter has been treated appropriately by the reviewed firm.
- b. Requesting the reviewed firm to submit a copy of its next inspection report.
- c. Requesting a reviewer to revisit the firm, at the firm's expense, to evaluate whether appropriate action has been taken.
- d. Requesting the reviewed firm to agree to accelerate the date of its next peer review.
- e. Requesting the reviewed firm to hire a competent party from outside the firm to review reports, accompanying financial statements, and related working papers, and to perform such other functions as the committee or the firm deem appropriate.
- f. Recommending to the executive committee that sanctions be imposed on the reviewed firm.

.09 APPENDIX A—Sample Letter of Response

Ark & Associates
Certified Public Accountants
New York, NY

October 15, 19__

PCPS Peer Review Committee
c/o American Institute of Certified
Public Accountants
Quality Review Division
Harborside Financial Center
201 Plaza Three
Jersey City, NJ 07311

Ladies and Gentlemen:

This letter represents our response to the letter of comments issued in connection with our firm's peer review for the year ended June 30, 19__. All of the necessary changes to our quality control policies and procedures will be closely monitored by our quality control and managing partners. In addition, the matters discussed in this letter will be given special emphasis in our next inspection program.

Matters That Resulted in a Modified Report¹**Supervision**

The firm has recalled all copies of its report on the financial statements referred to in the letter of comments, and the client is in the process of preparing corrected financial statements. To prevent the recurrence of such situations, we have obtained copies of comprehensive reporting and disclosure checklists. Our policies and procedures have been revised to require the in-charge accountant to complete the appropriate checklists and file them with the working papers. In addition, a step has been added to our engagement review checklist requiring the engagement partner to document his review of these checklists.

Consultation

All professional staff were reminded during a training session held October 10, 19__ of the need to consult with the appropriate authorities when complex issues arise and of the procedures to follow in such circumstances. On all large or complex engagements, the firm's

¹ This caption is to be used only if a modified or adverse report has been issued and should be tailored to fit the circumstances.

quality control partner will specifically inquire, before the report is issued, about compliance with our consultation policies. Furthermore, as noted in the first paragraph of this letter, compliance with the firm's consultation policies and procedures will be emphasized during our next inspection.

Matters That Did Not Result in a Modified Report²

Client Acceptance

Our firm's new client information form has been revised to provide for the managing partner's signature. In addition, we have advised our staff that an account number may not be assigned to a new client until the managing partner has signed the form.

Independence

Effective October 1, 19___, the firm amended its quality control document to require documentation of the resolution of all independence questions. A form has been developed to assist in such documentation and incorporated in the quality control document. In addition, we have added a step to our engagement review checklist covering this matter.

Supervision

At a training session held October 10, 19___, all professional staff were reminded of the firm's policy regarding the use of the standard programs in our audit and accounting manual and of the importance of complying with this policy. In addition, we have added a step to our engagement review checklist covering the use of appropriate standard programs, forms, and checklists.

Supervision

In January 19___, the firm acquired the office referred to in the letter of comments. An audit partner from our main office has been assigned the responsibility for training personnel of the acquired office in the firm's quality control policies and procedures, including the use of the firm's standard audit and work programs. The first two training sessions were held on October 6 and 13, and additional sessions have been scheduled for the next six weeks. In addition, the partner will spend one day a week at the new office monitoring its compliance with the firm's quality control policies and procedures.

² See footnote 1.

Continuing Professional Education

The five professionals referred to in the letter of comments have all registered for a sufficient number of continuing professional education courses to meet the current annual and three-year requirements. In addition, an individual has been assigned the responsibility of maintaining continuing professional education records for all professionals and preparing quarterly CPE reports for the quality control partner.

Sincerely,

Ark & Associates

PCPS
2400

Reviews of Quality
Control Materials

STANDARDS FOR PERFORMING AND REPORTING ON REVIEWS OF QUALITY
CONTROL MATERIALS

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Standards for Performing and Reporting on Reviews of Quality Control Materials

Introduction

- .01 Quality control materials (QCM) are materials that are suitable for adoption by a firm as an integral part of that firm's quality control system.¹ Such materials provide guidance in conforming with professional standards and may include, but are not limited to, such items as:
- a. Engagement aids, including accounting and auditing manuals, checklists, questionnaires, work programs, computer-aided accounting and auditing tools, and similar materials intended for use by accounting and auditing engagement teams
 - b. Personnel manuals, inspection checklists, hiring forms, and client acceptance and continuance forms
- .02 Occasionally, organizations (hereinafter referred to as "providers") may sell or otherwise distribute quality control materials that they have developed to CPA firms (hereinafter referred to as "user firms").
- .03 Providers may elect voluntarily or be required (PCPS §2400 .05, Applicability) to have an independent review of their system of quality control for the development and maintenance of the quality control materials they have developed and of the materials themselves.² The reasons for having such a review are—
- a. To provide assurance to user firms that the quality control materials they have acquired are reliable aids to assist them in conforming with the professional standards the materials purport to encompass.

¹ Continuing professional education programs are not included in the definition of quality control materials for purposes of this section. Reviews of continuing professional education programs that an organization may develop and sell or otherwise distribute to CPA firms are described briefly in PCPS §2500, "Guidelines for Review of Continuing Professional Education Programs."

² See Appendix C, PCPS §2400.27 for a discussion of the elements that a provider's system for the development and maintenance of quality control materials should include.

- b. To provide more cost-effective peer reviews for firms that have acquired such materials.
- c. To assure that independence and objectivity on peer reviews of user firms are maintained when such reviews are performed by providers.

Objectives of a Review of Quality Control Materials

- .04 The objectives of a review of quality control materials developed by a provider are—
 - a. To determine whether the provider's system for the development and maintenance of the quality control materials was suitably designed and was being complied with during the period under review to provide user firms with reasonable assurance that the materials are reliable aids to assist them in conforming with those professional standards the materials purport to encompass.
 - b. To determine whether the resultant materials are reliable aids.

Applicability

- .05 An independent review of the system for the development and maintenance of quality control materials and the resultant materials (the "QCM review") is required for the following classes of providers:
 - a. A member firm providing quality control materials to another member firm for which the provider firm will perform the peer review
 - b. An association of CPA firms providing quality control materials that meet the definition of association quality control materials to its member firms when the peer reviews of those firms are to be administered by the association³
- .06 A provider of quality control materials falling into either of these categories should have a QCM review once every three years. In the event of substantial change in the system for the development and maintenance of the materials or in the resultant materials, the provider should consult

³ See Appendix A, PCPS §3000.12, "Interpretation: Association Quality Control Materials."

with the private companies practice section peer review committee ("the committee") to determine whether an accelerated review is warranted.

- .07 Any other provider of quality control materials that voluntarily has a QCM review also will be subject to the standards in this section. A provider may have a review voluntarily so that peer reviewers of user firms can place reliance on the QCM review rather than having to review the quality control materials in detail.
- .08 All providers of quality control materials that have a QCM review must notify the committee in advance of that review in order to permit oversight by the committee. Providers must also notify the committee should the QCM review be discontinued.

Standards for Performing QCM Reviews

Qualifications for Serving as QCM Reviewers

- .09 A QCM review may be performed by a committee-appointed review team, by a firm that is a member of the section, or by an association or state CPA society appointed review team. Reviews of association quality control materials may not be performed by a member of the association whose materials are being reviewed. Furthermore, the committee will not appoint to the QCM review team a person with a firm that is a member of the association or a person or firm that may have a conflict of interest with respect to the QCM review, such as someone who assisted in the development or review of such materials or uses the materials as an integral part of the firm's quality control system.
- .10 A QCM reviewer shall possess the same qualifications set forth in the sections entitled "Organization of the Review Team" and "Qualifications for Service as a Reviewer" in PCPS §2000.24-.29. A member firm serving as a QCM reviewer must adhere to the guidelines included in "Qualifications for Service as a Reviewing Firm" in PCPS §2000.30-.36. In addition, associations and state CPA societies requested to perform QCM reviews must adhere to the guidelines contained in PCPS §3000 and §4000, "Guidelines for Involvement by Associations of CPA Firms" and "Guidelines for Involvement by State CPA Societies," respectively.

Procedures for Performing QCM Reviews

- .11 The provider should identify the materials to be reviewed and on which an opinion is to be expressed. A QCM review should include a study and evaluation of the system for the development and maintenance of the quality control materials that have been identified and a review of the materials themselves.
- .12 A study and evaluation of the system for the development and maintenance of quality control materials normally should include the following procedures:
 - a. Reviewing and evaluating the procedures established for developing quality control materials
 - b. Reviewing and evaluating the procedures established for updating (including distributing) the quality control materials to assure that the materials remain current and relevant when the provider has undertaken the responsibility for updating the materials
 - c. Reviewing the technical competence of the developer(s)/ updater(s) of the quality control materials
 - d. Obtaining evidence that the quality control materials were reviewed for technical accuracy by qualified person(s) other than the developer(s)/updater(s)
 - e. Determining whether the provider has appropriately communicated its policy regarding the period covered by the materials, the professional standards the materials purport to encompass, and the provider's intention to update the materials
 - f. Reviewing the system developed for soliciting and evaluating feedback from users of the quality control materials
- .13 A QCM review team should review the resultant quality control materials, to the extent deemed necessary, to evaluate whether the materials are reliable aids in conforming with those professional standards the materials purport to encompass.

Standards for Reporting on QCM Reviews

The Review Team's Report

- .14 Within thirty days of the date of the exit conference, the QCM review team should furnish the provider with a written

report and, if applicable, a letter of comments.⁴

Unqualified Report

- .15 An unqualified report issued by a QCM review team shall contain the following:
- a. A statement of the scope of the review
 - b. An identification of the quality control materials reviewed
 - c. A statement that the review was conducted in accordance with standards promulgated by the Committee
 - d. A description of the general characteristics of a system of quality control
 - e. A disclaimer regarding the application of the materials by user firms
 - f. An opinion (without modification) that the system of quality control for the development and maintenance of the quality control materials was suitably designed and was being complied with during the period under review to provide user firms with reasonable assurance that the materials are reliable aids to assist them in conforming with those professional standards the materials purport to encompass
 - g. An opinion (without modification) that the identified quality control materials are reliable aids
- .16 An example of an unqualified report is included in Appendix A, PCPS §2400.25.

Qualified Report

- .17 The following circumstances ordinarily would require a qualified report (modified, adverse, or disclaimed):

⁴ A QCM review team should communicate its findings to the provider organization at an exit conference. For guidance on preparing for and holding an exit conference, see the section entitled "Completion of the Review" discussed in PCPS §2000.78-.79.

- a. The scope of the review is limited by conditions that preclude the application of one or more review procedures considered necessary
 - b. The provider's system of quality control for the development and maintenance of quality control materials, as designed, did not provide user firms with reasonable assurance that reliable aids had been developed to assist them in conforming with those professional standards the materials purport to encompass
 - c. The degree of compliance with the provider's system of quality control for the development and maintenance of quality control materials was not sufficient to provide user firms with reasonable assurance that reliable aids had been developed to assist them in conforming with those professional standards the materials purport to encompass
 - d. The resultant quality control materials are not reliable aids to assist user firms in conforming with those professional standards the materials purport to encompass
- .18 In those instances in which the QCM review team determines that a qualified report is required, all the reasons should be disclosed and the QCM review team should consult with the Committee prior to the issuance of the report.

Letter of Comments

- .19 A letter of comments issued by a QCM review team should include the following:
- a. A reference to the report and, if applicable, an indication that the report was qualified
 - b. A description of the purpose of the QCM review
 - c. A statement that the review was conducted in accordance with standards promulgated by the committee
 - d. A description of the limitations of a system for the development and maintenance of quality control materials and of the materials themselves
 - e. The reviewer's findings, including sufficient detail with respect to the quality control materials so that user firms can determine the actions they need to take,

if any, to overcome the effects of the deficiencies noted

- f. A statement that the matters discussed in the letter were considered in determining the opinion on the system for the development and maintenance of the quality control materials and the resultant materials
- .20 If any of the matters to be included in the letter were included in the letter issued in connection with the provider's previous QCM review, that fact ordinarily should be noted in the description of the matter. In addition, although not required, the QCM review team may indicate how corrective action might be implemented. The letter may also include comments concerning actions taken, in process, or to be taken by the provider.
- .21 The letter of comments should include appropriate comments regarding the design of the provider's system of quality control for the development and maintenance of the quality control materials, or its compliance with that system, or deficiencies noted in the resultant quality control materials.⁵
- .22 Appendix B, PCPS §2400.26, illustrates how some of the foregoing matters may be covered in a letter of comments.
- .23 If a qualified report is issued, the letter must include a separate section on the matters that resulted in the qualification. This section would include an elaboration of the findings discussed in the qualifying paragraph of the report.

Letter of Response

- .24 The provider is required to respond in writing to the letter of comments. The response should be addressed to the committee and should describe the action(s) taken or planned with respect to each matter in the letter. If the provider disagrees with one or more of the comments, its response should describe the reasons for such disagreement. In the event that a material error or omission in the quality control materials is uncovered by the QCM review team, the response also should describe the provider's plan for notifying known users of that error or omission.

⁵ For guidance on evaluating whether a matter should be included in a letter of comments, see PCPS §2000.104-.105.

.25 APPENDIX A—Standard Form for an Unqualified Report

[AICPA or Other Appropriate Letterhead]

April 15, 19__

Executive Board
XYZ Organization

We have reviewed the system of quality control for the development and maintenance of (identify each item covered by the opinion or refer to an attached listing) ("materials") of XYZ Organization ("the organization") in effect for the year ended December 31, 19__ and the resultant materials in effect at December 31, 19__ in order to determine whether the materials are reliable aids to assist users in conforming with those professional standards the materials purport to encompass. [The organization has not undertaken the responsibility for maintaining the currency and relevancy of the quality control materials.]* Our review was conducted in accordance with the standards for reviews of quality control materials promulgated by the peer review committee of the private companies practice section of the AICPA Division for CPA Firms.

In performing our review, we have given consideration to the following general characteristics of a system of quality control. An organization's system for the development and maintenance of quality control materials encompasses its organizational structure and the policies and procedures established to provide the users of its materials with reasonable assurance that the quality control materials are reliable aids to assist them in conforming with professional standards in conducting their accounting and auditing practices. The extent of an organization's quality control policies and procedures for the development and maintenance of quality control materials and the manner in which they are implemented will depend upon a variety of factors, such as the size and organizational structure of the organization and the nature of the materials provided to users. Variance in individual performance and professional interpretation affects the

* To be included if the provider has not undertaken the responsibility for maintaining the currency and relevancy of the quality control materials. In this circumstance, all references to "maintenance" of the quality control materials should be deleted from the report and letter of comments.

degree of compliance with prescribed quality control policies and procedures. Therefore, adherence to all policies and procedures in every case may not be possible.

Our review and tests were limited to the system of quality control for the development and maintenance of the aforementioned materials of the XYZ Organization and to the materials themselves and did not extend to the application of these materials by users of the materials nor to the policies and procedures of individual users.

In our opinion, the system of quality control for the development and maintenance of the quality control materials of the XYZ Organization was suitably designed and was being complied with during the year ended December 31, 19__ to provide users of the materials with reasonable assurance that the materials are reliable aids to assist them in conforming with those professional standards the materials purport to encompass. Also, in our opinion, the quality control materials referred to above are reliable aids at December 31, 19__.

John Doe
Team Captain

or

ABC & Co. [for review by
a firm]

or

John Doe
Team Captain

[for review by an
association or
state CPA
society
sponsored
review team
team]

.26 APPENDIX B—Sample Letter of Comments

[Firm, Association or AICPA Letterhead]

April 15, 19__

[Should correspond with date of report]

Executive Board
XYZ Organization

We have reviewed the system of quality control for the development and maintenance* of (identify each item covered by the opinion or refer to an attached listing) ("materials") of XYZ Organization ("the organization") in effect for the year ended December 31, 19__ and the resultant materials in effect at December 31, 19__ and have issued our report thereon dated April 15, 19__ (which was modified as described therein)**. This letter should be read in conjunction with that report.

Our review was for the purpose of reporting upon your system of quality control for the development and maintenance of quality control materials and your compliance with that system, and upon whether the materials are reliable aids in assisting users in conforming with those professional standards the materials purport to encompass. Our review was conducted in accordance with the standards for reviews of quality control materials promulgated by the peer review committee of the private companies practice section of the AICPA Division for CPA Firms; however, our review would not necessarily disclose all weaknesses in the system or lack of compliance with it or all deficiencies in the quality control materials.

There are inherent limitations that should be recognized in considering the potential effectiveness of any system of quality control for the development and maintenance of quality control materials. In the performance of most control procedures, departures can result from misunderstanding of instructions,

* If the provider has not undertaken the responsibility for maintaining the currency and relevancy of the quality control materials, all references to "maintenance" of the quality control materials should be deleted from the letter of comments.

** To be included if a modified or adverse report is issued and should be tailored to fit the circumstances.

mistakes of judgment, carelessness, or other personal factors. Projection of any evaluation of a system of quality control for the development and maintenance of quality control materials or of the materials themselves to future periods is subject to the risk that the system or the materials may become inadequate because of changes in conditions or that the degree of compliance with the system may deteriorate or that the materials may become outdated.

Design of the Quality Control System

Finding—The organization's policies and procedures for the development and maintenance of quality control materials state that feedback on the materials is obtained by means of a questionnaire provided with the materials. The organization's policies and procedures do not specify the procedures to be followed for reviewing and analyzing returned questionnaires. As a result, our review of the questionnaires received by the organization during the review period indicated that the questionnaires were being read, but that they were not being summarized or analyzed to determine whether the quality control materials require change.

Recommendation for improvement—The organization should revise its policies and procedures for the development and maintenance of quality control materials to include procedures for reviewing, summarizing, and analyzing the feedback received on its quality control materials in order to determine whether the materials require change(s) to provide reasonable assurance that the materials are reliable aids to assist users in conforming with those professional standards the materials purport to encompass.

Noncompliance with the Quality Control System

Finding—The organization's policies and procedures require that a technical review of all quality control materials be performed by a qualified person other than the developer to ensure that the materials are reliable aids to assist users in conforming with those professional standards the materials purport to encompass. During our review, we noted that such a technical review was performed on all of the materials we reviewed except for the current edition of the financial statement disclosure and reporting checklist. However, we were satisfied that the checklist is a reliable aid.

Recommendation for improvement—The organization should remind its personnel of the importance of complying with its technical review policy. In addition, the organization may wish to implement other controls to ensure compliance with this policy.

Deficiency in the Quality Control Materials

Finding—In our review of the organization's accounting and auditing manual, we noted that there was no guidance for the avoidance of unwarranted reliance on computer-generated reports. Furthermore, in our review of the organization's quality control policies and procedures manual, we noted that the manual states that the completion of the organization's Environmental Information Form will provide sufficient documentation to enable a user to obtain an understanding of the flow of transactions through the computerized portion of an accounting system. As presently designed, the Environmental Information Form, when completed, ordinarily will not, by itself, provide sufficient documentation.

Recommendation for improvement—The organization, in its next revision of its manuals, should provide guidance for the avoidance of unwarranted reliance on computer-generated reports and modify the Environmental Information Form or develop other aids so that, when properly completed, it/they will provide sufficient information about the computerized portion of an accounting system to enable a user to obtain an understanding of the flow of transactions through it.

The foregoing matters were considered in determining our opinion set forth in our report dated April 15, 19__, and this letter does not change that report.

John Doe
Team Captain

or

ABC & Co. [for review by
a firm]

or

John Doe
Team Captain

[for review by an
association or
state CPA
society
sponsored review
team]

.27 APPENDIX C—Elements of a Provider's System for the
Development and Maintenance of Quality Control
Materials

1. A provider's system for the development and maintenance of quality control materials normally should include—
 - a. A requirement that the quality control materials be developed by individuals qualified in the subject matter.
 - b. A requirement that the quality control materials be reviewed for technical accuracy by qualified person(s) other than the developer(s) to ensure that the materials are reliable aids to assist users in conforming with those professional standards the materials purport to encompass.
 - c. Procedures to ensure the currency and relevancy of the quality control materials.
 - d. Procedures for soliciting and evaluating feedback from users of the quality control materials.
 - e. Procedures for communicating the period and, where appropriate, the professional standards encompassed by the materials, and the provider's policy, if any, regarding the issuance of updates to the materials and, if a policy exists, the method of updating.
 - f. Procedures for ensuring that the materials are updated in accordance with the provider's policy when it has undertaken to update them.

.28 APPENDIX D—Guidance For Firms Using Acquired Quality Control Materials

Introduction

1. A firm's quality control materials are those materials that have been adopted as an integral part of the firm's quality control system. Such materials provide guidance in conforming with professional standards and may include, but are not limited to, such items as:
 - a. Engagement aids, including accounting and auditing manuals, checklists, questionnaires, work programs, computer-aided accounting and auditing tools, and similar materials intended for use by accounting and auditing engagement teams
 - b. Personnel manuals, inspection checklists, hiring forms, and client acceptance and continuance forms
2. Some firms ("user firms") acquire these materials from another accounting firm or some other third party and require their personnel to use the materials during the performance of accounting and auditing engagements or elsewhere in its system of quality control. The following guidance has been developed to assist firms in discharging their responsibilities when they acquire quality control materials from others.

Guidance For User Firms

3. Users of acquired quality control materials are obligated to evaluate whether the materials are reliable aids to assist them in conforming with those professional standards the materials purport to encompass. If the materials have been subjected to an independent review ("QCM review"), a user firm should obtain and review the report and, if applicable, the letter of comments and response thereto from the provider, and determine whether the firm should establish compensating policies and procedures as a result of any deficiencies identified in the report or letter of comments. If the materials have not been subjected to an independent QCM review, the user firm must evaluate whether the materials are reliable aids to assist it in conforming with those professional standards the materials purport to encompass.
4. Regardless of whether the acquired quality control materials have been subjected to an independent QCM review, the user firm is responsible for tailoring the materials, to the extent appropriate, to provide it with reliable aids to assist its professional personnel in conforming with those

professional standards the materials purport to encompass and for integrating those materials into its practice.¹ A user firm should establish a plan for doing these. Such a plan would ordinarily include—

- a. Identifying the materials that personnel must use during the performance of accounting and auditing engagements.
 - b. Tailoring the materials to the firm's practice.²
 - c. Communicating the firm's policies and procedures for using the materials to the professional personnel.
 - d. Training the professional personnel in the use of the materials.
5. It is the user firm's responsibility to ensure that its quality control materials remain current and relevant if the provider has not undertaken the responsibility for updating the materials. Where the provider has undertaken such a responsibility, the user firm should monitor that updates are received on a timely basis and are in accordance with those professional standards the updates purport to encompass. In the event that a provider does not undertake the responsibility for updating quality control materials or if a user has not received timely updates, the user firm should establish appropriate quality control policies and procedures to provide it with reasonable assurance of conforming with those recently issued professional standards that the provider's quality control materials do not encompass.

¹ Where a firm has acquired quality control materials that have been subjected to a QCM review, the peer reviewer may rely on the results of the QCM review. However, the reviewer must still evaluate whether the firm has appropriately tailored the materials and integrated them into its practice.

² The user firm should be aware that the piecemeal utilization of a provider's quality control materials may violate the integrity of the design of the materials.

PCPS
2500

Reviews of Continuing
Professional Education
Programs

GUIDELINES FOR REVIEW OF CONTINUING PROFESSIONAL EDUCATION PROGRAMS

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Guidelines for Review of Continuing Professional Education Programs

Introduction

- .01 Associations of CPA firms authorized to arrange and carry out peer reviews are required to submit to an independent review of the materials that constitute association quality control materials and of the related system of quality control for the development and maintenance of the materials at least once every three years. (Other providers of quality control materials may opt for an independent review of these materials.) In the event of substantial change in the system or in the resultant materials, the third-party provider should consult with the private companies practice section peer review committee to determine whether an accelerated review is warranted.
- .02 The following discussion describes the guidelines that a review team should follow in reviewing continuing professional education programs ("CPE programs") that constitute association quality control materials.¹

Qualifications of Review Teams

- .03 A review of association CPE programs may be performed by a committee-appointed review team, by a firm that is a member of the section, or by an association or state CPA society appointed review team. Reviews of association CPE programs may not be performed by a member of the association or subscriber to the third party materials. Furthermore, the committee will not appoint to the review team a person with a firm that is a member of the association or a person or firm that may have a conflict of interest with respect to the review, such as someone who assisted in the development, review, or presentation of the CPE programs or uses the programs as an integral part of the reviewing firm's quality control system.

Review Procedures

- .04 The review should include a study and evaluation of the system of quality control for the development and maintenance of the CPE programs and a review of the CPE programs themselves. Such a review normally should include—

¹ See PCPS §2400, "Standards for Performing and Reporting on Reviews of Quality Control Materials" for information on reviews of quality control materials other than CPE programs.

- a. Obtaining a description of the system of quality control for the development and maintenance of the CPE programs.
- b. Obtaining a description of the objectives of the CPE programs.
- c. Reviewing the qualifications (subject matter and instruction design) of the developer(s) and reviewer(s) of the CPE programs.
- d. Obtaining evidence that the CPE programs were reviewed by qualified person(s) other than the developer(s).
- e. Reviewing and evaluating the procedures established for updating the CPE programs to ensure that they remain current and relevant and for communicating any relevant changes in professional standards, to program participants should new professional standards be issued prior to updating the CPE programs.
- f. Reviewing the system developed for soliciting and evaluating feedback on the CPE programs.
- g. Testing documentation evidencing compliance with the system.
- h. Reviewing selected instructor and participant manuals and evaluating whether the materials appear to accomplish the program's objectives.
- i. Evaluating whether the applicable AICPA standards for CPE program development and presentation that are not covered by the provider's procedures are being achieved. (See PCPS §6000.33-.49 "Requirements for Formal Continuing Professional Education Program Development and Presentation").

Reporting on a Review

- .05 For assistance in preparing the report and letter of comments, if any, on the review of the quality control system for the development and maintenance of CPE programs and of the CPE programs themselves, the reviewer should refer to the general guidelines set forth in PCPS §2400.14-.23, "Standards for Performing and Reporting on Reviews of Quality Control Materials."

PCPS
2600

Report Reviews

GUIDELINES FOR A REPORT REVIEW

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Guidelines for a Report Review

Introduction

- .01 The executive committee of the private companies practice section ("PCPS") has determined that, for the purpose of complying with the membership requirement of PCPS §1000.07(c), "Organizational Structure and Functions of the Private Companies Practice Section," firms that issue compilation or review reports but perform no audits may elect, instead of a peer review conducted in accordance with PCPS §2000, "Standards for Performing and Reporting on Peer Reviews," a report review conducted in accordance with these guidelines. These guidelines have been established by the PCPS peer review committee to provide guidance to the reviewed firm and to the reviewers in connection with performing and reporting on such reviews.

Nature of Report Reviews

- .02 Compilation and review engagements differ substantially from audit engagements. A compilation of financial statements is limited to presenting in the form of financial statements information that is the representation of management, and the accountant does not express an opinion or any other form of assurance on them. A review of financial statements consists principally of inquiries of company personnel and analytical procedures applied to financial data; it is substantially less in scope than an audit and the accountant undertakes only to achieve limited assurance that there are no material modifications that should be made to the financial statements in order for them to be in conformity with generally accepted accounting principles. In an audit, however, the auditor has an obligation to perform such procedures as considered necessary in the circumstances to express a professional opinion on the financial statements taken as a whole.
- .03 Because of the nature and limitations of compilation and review engagements, report reviewers, in reviewing such engagements, ordinarily place greater weight on whether the financial statements and the accountant's report appear to be in conformity with professional standards than on the documentation of compliance with the performance standards of Statements on Standards for Accounting and Review Services (SSARS). SSARS 1 places little emphasis on the matters that should be described in the accountant's compilation or review working papers. Accordingly, the executive committee has determined that it is appropriate to institute report reviews for firms that issue compilation or review reports but perform no audits.

- .04 The objective of a report 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 a peer review in recognition of the fact that report 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 clearly expresses only limited assurance about the financial statements, and an accountant's compilation report states that the accountant expresses no opinion or other form of assurance on the historical or prospective financial statements. Such firms will only be required to have a report review unless they elect to have a peer review. However, this does not relieve such firms from their obligation to have a system of quality control.

Compliance with Other Membership Requirements

- .05 Firms that elect a report review must provide the reviewer with certain evidential matter concerning the firm's compliance with other PCPS membership requirements.

Basic Requirements for Report Reviews**Conditions for a Report Review**

- .06 In arranging the review, the firm should represent that (a) it expects to have performed no audits during the year under review, and (b) that it will immediately notify the AICPA Quality Review Division if, prior to the date of the review, it is engaged to perform an audit.¹
- .07 The firm should agree to respond promptly to questions raised by the reviewer or by the staff in the course of the review and to cooperate with the peer review committee in resolving any disagreements.¹

¹ Failure to comply with these conditions may result in the automatic termination of the firm's membership in the PCPS as discussed in Appendix A, PCPS §1000.37, "Automatic Suspension and Termination of Members That Fail to Meet Certain Membership Requirements."

Appointment of Report Reviewers

- .08 Report reviewers may be appointed by the peer review committee, or may be engaged by the reviewed firm on a firm-on-firm basis. Associations of CPA firms may also arrange or carry out reviews under these guidelines.
- .09 Report reviewers should comply with the guidance in PCPS §2000.11-.23, "Standards for Performing and Reporting on Peer Reviews," on confidentiality, independence, conflict of interest, competence, and due care.
- .10 The nature and complexity of a report review requires the exercise of professional judgment. Accordingly, an individual serving as a report reviewer must be a member of the AICPA licensed to practice as a certified public accountant, must possess current knowledge of accounting matters, and must have at least five years of recent experience in the practice of public accounting in the accounting function. In addition, the reviewer must be currently active in public practice as a sole practitioner, a partner, or shareholder of a firm that is a member of PCPS and that has had a peer review or report review and the report on the most recent committee accepted peer or report review is unqualified. It is highly recommended, but not required, that a report reviewer attend an applicable reviewer's training course using AICPA materials. However, individuals performing report reviews on or after April 1, 1994, must have completed an applicable training course within five years preceding commencement of the review.

Information Required Before Review Begins

- .11 The firm should provide the AICPA Quality Review Division staff with the following information concerning the arrangements for the review:
 - a. A written representation as to the matters covered in PCPS §2600.06
 - b. Number of compilation and review engagements by type and industry
- .12 The firm should provide the report reviewer with:
 - a. A list of professional staff showing name, position, length of service, and whether the individual is a CPA and a member of the AICPA
 - b. Photocopies of the continuing professional education records specified in PCPS §6000.28-.29, "Continuing Professional Education Requirements," for each professional for each of the educational years since joining the section, up to a maximum of the three most recent educational years

- c. Evidence of payment of AICPA membership dues for all partners in the firm eligible for membership
- d. Evidence of payment of its dues to the PCPS
- e. A copy of its most recent annual report that was filed with the PCPS

Engagement Selection and Review

- .13 On the basis of the information provided under PCPS §2600.11, the report reviewer ordinarily shall select the types of engagements to be submitted for review in accordance with the following criteria:
- a. Select one review or compilation engagement involving a report on a complete set of financial statements as opposed to compilation reports on financial statements that omit substantially all of the disclosures required by generally accepted accounting principles or an other comprehensive basis of accounting, for each proprietor, partner, or shareholder responsible for the issuance of such reports. However, at least two engagements must be selected for the firm.
 - b. In selecting engagements for review, include both review and compilation engagements, if both levels of service are provided. Also, attempt to include clients operating in different industries and engagements involving prospective financial statements as well as those involving historical financial statements.
 - c. In addition to the selection made in a, select, where applicable, one set of financial statements that omit substantially all of the disclosures required by generally accepted accounting principles or an other comprehensive basis of accounting and the related accountant's compilation report. However, if the firm's accounting practice consists only of compilation reports on financial statements that omit substantially all required disclosures, the firm must submit the financial statements and related accountant's report for two such engagements.

Within thirty days of being notified by the reviewer of the types of engagements selected for review, the reviewed firm shall submit the appropriate financial statements and accountant's report, masking client identity if it desires, along with specified background information and representations about each engagement.

- .14 A report 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. A report 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 a peer review.

- .15 Accordingly, a report review does not provide the report 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.
- .16 A firm that has a report 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 report reviewer will contact the firm, before issuing his or her report, to resolve questions raised in the review.
- .17 Although a report review does not provide the report 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 report 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.
- .18 The report reviewer performing a report review must document the work performed using the programs and checklists issued by the PCPS peer review committee for that purpose. Failure to complete all relevant programs and checklists in a professional manner creates the presumption that the review has not been performed in conformity with these guidelines. Such a review cannot be accepted as meeting the requirements of the PCPS.

Guidelines for Reporting on a Report Review**General**

- .19 Within thirty days of the date of completion of a report review, the report reviewer 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 an association of CPA firms is to be issued on the association's letterhead. A report by a committee-appointed review team is to be issued on AICPA Division for CPA Firms' letterhead. The review report and letter of comments should be addressed to the proprietor, partners, shareholders, or officers of the reviewed firm and ordinarily should be dated as of the completion of the review procedures.
- .20 The report reviewer or, where provided by its plan of administration, an authorized association of CPA firms, should notify the AICPA Quality Review Division that the review has been completed and should submit to the AICPA Quality Review Division a copy of the report and letter of comments, if any, and the working papers specified in the programs and checklists issued by the PCPS peer review committee.
- .21 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 and letter of comments to the AICPA Quality Review Division within thirty days of the date it received the report and letter of comments. The response should be addressed to the PCPS peer review committee and should describe the actions taken or planned with respect to each matter in the letter of comments. If the reviewed firm disagrees with one or more of the findings or recommendations, its response should describe the reasons for such disagreement.
- .22 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 PCPS peer review committee as meeting the requirements of the PCPS.

Reports

- .23 The written report on a report 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 report 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. A statement should also be made expressing limited assurance that the firm is in compliance with the membership requirements of the Section in all material respects and, if not, a description of the reason(s).

- .24 A report reviewer may issue an unqualified, qualified, or adverse report on the review. The standard form of the unqualified report is illustrated in Appendix A (PCPS §2600.31). Illustrations of qualified and adverse reports are presented in Appendix B, C and D, PCPS 2600.32, 2600.33, and 2600.34.
- .25 The objective of a report review is to provide the report 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.
- .26 As indicated in paragraph 2600.15, a report 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 a report review support the expression of such a 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 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 a report review only addresses conformity with professional standards and not the system of quality control.

Letter of Comments

- .27 A letter of comments is required to be issued in connection with a report review when there are matters that resulted in qualification(s) to the standard form of report or when the report 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. Such a letter should provide reasonably detailed findings and recommendations so the PCPS peer review committee can evaluate whether the actions taken or planned by the firm in connection with the review appear appropriate in the circumstances.
- .28 If any of the matters to be included in the letter were included in the letter issued in connection with the firm's previous review, that fact should be noted in the description of the matter.
- .29 When a letter of comments is issued along with a qualified or adverse report, the report on the review must make reference to the letter. No reference should be made to the letter of comments in an unqualified report.

- .30 The letter of comments should be prepared in accordance with the guidance and illustrations in Appendix E, PCPS §2600.35. An illustration of a response by a reviewed firm is included in Appendix F, PCPS §2600.36.

.31 APPENDIX A—Illustration of an Unqualified Report

[AICPA, firm, or
other letterhead, as applicable]

August 31, 19XX

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

We (I) have performed a report review with respect to the accounting practice of (the firm) for the year ended June 30, 19XX, in accordance with guidelines established by the peer review committee of the private companies practice section of the AICPA Division for CPA Firms (the section). We (I) also tested compliance with the membership requirements of the section to the extent we (I) considered appropriate. The membership requirements of the section make this type of review available to firms that perform no audits of historical or prospective financial statements. (The 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.

A report 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. A report 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) report 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 (the 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. In addition, nothing came to our (my)

* To be included, as appropriate.

attention that caused us (me) to believe that the firm did not conform with the membership requirements of the section in all material respects.

John Doe
Report Reviewer[†]

[for CART and
association
sponsored
reviews]

or

Jackson & Allen, P.A.

[for
review by
a firm]

[†] The description *Report Reviewer* not *Team Captain*, should be used in reports on report reviews.

.32 APPENDIX B—Illustration of a Qualified Report

[AICPA, firm, or other
letterhead, as applicable]

August 31, 19XX

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

We (I) have performed a report review with respect to the accounting practice of (the firm) for the year ended June 30, 19XX, in accordance with guidelines established by the peer review committee of the private companies practice section of the AICPA Division for CPA Firms (the section). We (I) also tested compliance with the membership requirements of the section to the extent we (I) considered appropriate. The membership requirements of the section make this type of review available to firms that perform no audits of historical or prospective financial statements. (The 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.

A report 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 requirements of professional standards. A report 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.

[Separate paragraph 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

* To be included, as appropriate.

disclosure deficiencies concerning related-party transactions were noted in several of the engagements reviewed.

[Concluding paragraph]

In connection with our (my) report 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 or review reports submitted for review by (the 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. In addition, 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 in all material respects.

John Doe
Report Reviewer†

[for CART and
association
sponsored
reviews]

or

Jackson & Allen, P.A.

[for
review by
a firm]

† The description *Report Reviewer* not *Team Captain*, should be used in reports on report reviews.

.33 APPENDIX C—Illustration of an Adverse Report

[AICPA, firm, or other
letterhead, as applicable]

August 31, 19XX

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

We (I) have performed a report review with respect to the accounting practice of (the firm) for the year ended June 30, 19XX, in accordance with guidelines established by the peer review committee of the private companies practice section of the AICPA Division for CPA Firms (the section). We (I) also tested compliance with the membership requirements of the section to the extent we (I) considered appropriate. The membership requirements of the section make this type of review available to firms that perform no audits of historical or prospective financial statements. (The firm) has represented to us that it performed no audits [(or compilations) (or reviews)]* of historical or prospective financial statements during the year ended June 30, 19XX.

A report 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. A report 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.

[Separate paragraph 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

* To be included, as appropriate.

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 (the 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. In addition, we (I) 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.

John Doe
Report Reviewer[†]

[for CART and
association
sponsored
reviews]

or

Jackson & Allen, P.A.

[for
review by
a firm]

[†] The description *Report Reviewer* not *Team Captain*, should be used in reports on report reviews.

.34 APPENDIX D—Illustration of a Qualified Report for Noncompliance
with Membership Requirements

[AICPA, firm, or other
letterhead, as applicable]

August 31, 19XX

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

We (I) have performed a report review with respect to the accounting practice of (the firm) for the year ended June 30, 19XX, in accordance with guidelines established by the peer review committee of the private companies practice section of the AICPA Division for CPA Firms (the section). We (I) also tested compliance with the membership requirements of the section to the extent we (I) considered appropriate. The membership requirements of the section make this type of review available to firms that perform no audits of historical or prospective financial statements. (The 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.

A report 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. A report 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) report 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 (the firm) and issued in the conduct of its accounting practice

* To be included, as appropriate.

during the year ended June 30, 19XX, did not conform with the requirements of professional standards in all material respects.

In addition, except for the failure of a significant number of professionals to participate in the required number of hours of qualifying 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 in all material respects, as discussed in our (my) letter of comments under this date.

John Doe
Report Reviewer[†]

[for CART and
association
sponsored
reviews]

or

Jackson & Allen, P.A.

[for
review by
a firm]

[†] The description *Report Reviewer* not *Team Captain*, should be used in reports on report reviews.

.35 **APPENDIX E—Guidance for and Illustration of a Letter of Comments**

1. The objectives of the letter of comments on a report review are set forth in the Guidelines. Such letters are expected to be issued on many report reviews.

2. The letter should be addressed, dated, and signed in the same manner as the report on the report 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 report review.
- c. A statement that the review was performed in accordance with guidelines established by the peer review committee of the private companies practice section of the AICPA Division for CPA Firms.
- 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 quality review or 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 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.

Sample Letter of Comments

[AICPA, firm, or other
letterhead, as applicable]

August 31, 19XX

To the Partners
Able, Baker & Co.

or

To John B. Able, CPA

We (I) have performed a report review with respect to the accounting practice of (the firm) for the year ended June 30, 19XX, in accordance with guidelines established by the peer review committee of the private companies practice section of the AICPA Division for CPA Firms (the section), 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.

A report 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. A report 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.]

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

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

William Brown
Report Reviewer[†]

[for CART and
association
sponsored
reviews]

or

Jackson & Allen, P.A.

[for
review by
a firm]

[†] The description *Report Reviewer* not *Team Captain*, should be used in reports on report reviews.

**Examples of Matters That Might Be Included in
Letters of Comments**

Matters That Resulted in a Qualified or Adverse Report[†]

1. Finding: During our review, we noted that the firm did not modify its reports on financial statements when those 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 reports and financial statements issued by the firm, we noted numerous instances where the firm failed to adhere to professional standards in such areas as (1) failure to disclose material intercompany transactions, (2) failure to appropriately recognize revenue, (3) failure to present financial statements in a proper format, and (4) 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.

[†] 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: 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 Statement on Standards for Accounting and Review Services (SSARS) 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 Report⁵

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 generally accepted accounting principles 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.

⁵ 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.

.36 **APPENDIX F – Illustration of Response by a Reviewed Firm to a Letter of Comments**

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. 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. If the firm has received a qualified or adverse report, the firm's responses should be separated for those findings that resulted in a qualified or adverse report and those that did not.

Sample Letter of Response

Ark & Associates
Certified Public Accountants
New York, NY

October 15, 19XX

PCPS Peer Review Committee
c/o American Institute of Certified
Public Accountants
Quality Review Division
Harborside Financial Center
201 Plaza Three
Jersey City, New Jersey 07311-3881

Ladies and Gentlemen:

This letter represents our (my) response to the letter of comments on the report review of our (my) 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 (I) have obtained copies of the AICPA reporting and disclosure checklists. These checklists will be completed on all review engagements and all compilations 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]

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ASSOCIATIONS

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Guidelines for Involvement by Associations of CPA Firms**Introduction**

- .01 The objective of these guidelines is to establish procedures under which an association of CPA firms may arrange and carry out private companies practice section (PCPS) peer reviews that will meet the section's peer review membership requirement. Peer reviews arranged and carried out by an association of CPA firms will meet the requirements of the private companies practice section if they are conducted in accordance with PCPS §2000, "Standards for Performing and Reporting on Peer Reviews," and if the association does the following: (1) maintains its independence and the independence of its member firms; (2) submits a plan of administration to the PCPS peer review committee for approval; (3) establishes policies and procedures to ensure that the reviews are carried out in a manner consistent with PCPS peer review standards; and, (4) submits to administrative reviews.
- .02 Reviews arranged and carried out by an association of CPA firms may be conducted by a team appointed by the association or by a reviewing firm that is a member of the same association as the reviewed firm. For the review to be under the auspices of the association, a majority of the review team members, including the team captain, must be from association member firms.

Requirements for Involvement**Independence**

- .03 When peer reviews are arranged and carried out by an association of CPA firms, the association and its member firms must meet the following independence criteria:
- a. The association, as distinct from its member firms, does not perform any professional services other than those it provides to its member firms.
 - b. The association does not engage in any of the advertising or solicitation activities that are permitted with respect to member firms except that an association may respond to inquiries and may prepare brochures that firms may use to obtain professional engagements.
 - c. The association does not warrant or make public representations regarding the quality of professional services performed by its member firms. However, member firms may independently publicize their membership in the association.

- d. The association has an independent review of those materials that could be considered an integral part of its member firms' quality control systems (association quality control materials).¹
 - e. Member firms of the association do not share directly or indirectly, or participate in, the profits of each other. (Correspondent fees are considered revenue, not profit participation.)
 - f. Referral or participating work among member firms is arranged directly by the firms involved.
 - g. The association does not exercise any direct or indirect management control over the professional or administrative functions of its member firms.
- .04 The association should submit a statement that it conforms with the aforementioned independence criteria prior to commencing peer reviews and at the beginning of each subsequent year in which the association desires to be authorized to arrange and carry out peer reviews.

Plan of Administration

- .05 The association must submit a plan of administration to the PCPS peer review committee for approval prior to performing any peer reviews. The plan of administration should outline how the association will arrange and carry out the peer reviews of its members, and should be filed annually to maintain involvement in the program. A questionnaire, which can serve as an association's plan, will be provided to involved associations on an annual basis, and to others upon request.
- .06 The association may renew its plan of administration by submitting an updated plan of administration at the beginning of each subsequent year.

Administrative Reviews

- .07 An association of CPA firms that is authorized to arrange and carry out peer reviews shall submit triennially to a review of its administrative procedures and to a review of any association quality control materials. These reviews may be performed concurrently; however, separate reports should be issued. The

¹ See **Appendix A**, PCPS §3000.12, "*Interpretation: Association Quality Control Materials*," for a discussion of association quality control materials.

reviewer shall possess the same qualifications as those required for team captains on peer reviews.

- .08 Triennial reviews. Every three years the association should submit its procedures for arranging and carrying out the peer review program to a review by an independent reviewer. The initial administrative review should be performed during the third year that the association is involved in the PCPS peer review program. Such reviews may be performed by a committee-appointed review team or by a firm that is a member of the section, provided that such firm is not a member of the association under review or a member of another association that uses materials that constitute association quality control materials for the association under review. The committee will not appoint to the review team a person with a firm that is a member of the association or a person who may have a conflict of interest with respect to the review.
- .09 Reviews of association quality control materials. In the event that materials used by its members constitute association quality control materials, the association shall arrange for an independent review of those materials and the related system of quality control.²
- .10 The report resulting from the review of the materials, the letter of comments, if any, and the letter of response thereto, should be made available to the association member firms and their reviewers and relied upon during the performance of association-administered peer reviews.³

Oversight

- .11 The PCPS peer review committee has the right to monitor an association's administrative and/or review activities relating to the peer review program and to review the work of an individual review team.

² See PCPS §2400, "Standards for Performing and Reporting on Reviews of Quality Control Materials," or, in the case of other types of materials, PCPS §2500, "Guidelines for Review of Continuing Professional Education Programs."

³ The association should advise the reviewers of its member firms that they should consider both the report relating to the association quality control materials and whether the reviewed firm tailored the materials, to the extent appropriate, to its practice and properly integrated the materials into its practice. The report on the reviewed firm should not, however, make reference to the review of the materials.

**.12 APPENDIX A—Interpretation: Association Quality
Control Materials**

Definition

1. Association quality control materials are materials that are either—
 - a. Prepared by the association or a member firm(s) for use by its member firms.
 - b. Composed of materials or programs provided by a third party and tailored for or developed for the association or its member firms.

Examples of Association Quality Control Materials

2. Example 1. The XYZ Company is contracted to present to member firms of an association a course on EDP auditing that is tailored to the needs of its members. Such a course would constitute an association quality control material because the course was tailored to the individual association needs.
3. Example 2. The XYZ Company is contracted to present to newly hired assistants of association member firms a course on working paper techniques. This course is identical to the course presented to other groups and is not modified or tailored for the association. Such a course would not be considered an association quality control material.
4. Example 3. An accounting firm that is not a member of the association has agreed to supply its own accounting and auditing manual to all the association member firms. Such a manual, since it was not tailored for or developed for the association and its member firms, would not constitute an association quality control material.

.13 APPENDIX B—Sample Unqualified Report on Review of Association Peer Review Program Administrative Procedures

[Firm or AICPA Letterhead]

May 15, 19__

Executive Committee
XYZ Association

We have reviewed the procedures followed by the XYZ Association during the year ended December 31, 19__ in arranging and carrying out peer reviews under the authorization of the peer review committee of the private companies practice section of the AICPA Division for CPA Firms (the section). Our review was conducted in accordance with the section's Program for Monitoring Authorized Association and State CPA Society Arranged Peer Reviews and included tests of the association's compliance with the section's "Guidelines for Involvement by Associations of CPA Firms."

In our opinion, the XYZ Association has complied during the year ended December 31, 19__ with the guidelines established by the section for association arranged peer reviews.

John Doe
Team Captain

or

Brown & Co. [for review by]
[a firm]

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STATE CPA SOCIETIES

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Guidelines for Involvement by State CPA Societies

Introduction

- .01 The objective of these guidelines is to establish procedures under which state CPA societies may arrange and carry out private companies practice section (PCPS) peer reviews that will meet the section's peer review membership requirement. Peer reviews arranged and carried out by a state CPA society will meet the requirements of the private companies practice section if they are conducted in accordance with PCPS §2000, "Standards for Performing and Reporting on Peer Reviews" and if the state CPA society's peer review program adheres to the requirements set forth below.
- .02 The private companies practice section recognizes that, subject to applicable state laws, state CPA societies may, upon request, conduct reviews for firms in other states or, because of size or population limitations, may form groups of state CPA societies to centralize the review function.

Requirements for Involvement

- .03 Each state CPA society that wishes to become authorized to arrange and carry out PCPS peer reviews must adhere to the following:
 - a. Prior to commencing peer reviews, the state CPA society must submit a plan of administration to the PCPS peer review committee for approval. The plan should delineate the procedures that the state society will follow in arranging and carrying out the peer review program. The state CPA society may renew its plan of administration by submitting an updated plan at the beginning of each subsequent year. A questionnaire, which can serve as a state CPA society's plan, will be provided to involved state CPA societies on an annual basis, and to others upon request.
 - b. Triennially, the state CPA society must submit its procedures for arranging and carrying out the peer review program to a review by an independent reviewer. The initial administrative review should be performed during the third year that the state CPA society is involved in the PCPS peer review program. Such reviews may be performed by a committee-appointed review team or a member firm. The reviewer shall possess the same qualifications as those required for team captains on peer reviews. The committee will not appoint to the review team a person who may have a conflict of interest with respect to the review or the state CPA society.

Administration

- .04 A state CPA society that wishes to arrange and carry out PCPS peer reviews should establish a quality control review committee. The size of that committee will depend on a number of factors, including the available state society staff support, the complexities of the plan of administration, the number of CPA firms anticipated to participate, and the geographical areas served.
- .05 The quality control review committee should be responsible for the following:
- a. Developing the plan of administration
 - b. Developing and maintaining the pool of reviewers
 - c. Scheduling the reviews and selecting the reviewers
 - d. Training and evaluating the reviewers
 - e. Determining that reviews are conducted in accordance with PCPS guidelines
 - f. Resolving disagreements that may arise between a reviewed firm and the state society reviewers and reporting unresolved disputes to the PCPS peer review committee
 - g. Maintaining files containing information on peer reviews arranged and carried out by the state CPA society. Such files would normally include—
 1. Data regarding the qualifications of reviewers.
 2. A list of firms reviewed, reviewers on each review, and dates of the reviews.
 3. Review team working papers retained in accordance with the section's requirements.¹
 - h. Coordinating the state CPA society program with the PCPS peer review committee

¹ See "Retention Period" under "Review Team Working Papers" in PCPS §5000, "Administrative Procedures of the Peer Review Committee."

Oversight

- .06 The PCPS peer review committee has the right to monitor a society's administrative and/or review activities relating to the peer review program and to review the work of an individual review team.

.07 APPENDIX—Sample Unqualified Report on Review of State CPA Society Peer Review Program Administrative Procedures

[Firm or AICPA Letterhead]

May 15, 19__

To the XYZ State Society of CPAs
Quality Control Review Committee

We have reviewed the procedures followed by the XYZ State Society of CPAs during the year ended December 31, 19__ in arranging and carrying out peer reviews under the authorization of the peer review committee of the private companies practice section of the AICPA Division for CPA Firms (the section). Our review was conducted in accordance with the section's Program for Monitoring Authorized Association and State CPA Society Arranged Peer Reviews and included tests of the state CPA society's compliance with the section's "Guidelines for Involvement by State CPA Societies."

In our opinion, the XYZ State Society of CPAs has complied during the year ended December 31, 19__ with the guidelines established by the section for state society arranged peer reviews.

John Doe
Team Captain

or

Brown & Co. [for review by
a firm]

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ADMINISTRATION

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Administrative Procedures of the Peer Review Program**Introduction**

- .01 This section sets forth the procedures to be followed in administering the private companies practice section (PCPS) peer review program. They have been approved by the PCPS peer review committee.
- .02 Peer reviews may be conducted by a review team that meets any of the following criteria:
- a. Appointed by the committee (a "CART" review)
 - b. Formed by a member firm engaged by the firm to be reviewed (a "firm-on-firm" review)
 - c. Formed by a state CPA society or an association of CPA firms authorized by the committee to perform peer reviews

Source of Reviewers**Committee-Appointed Review Teams**

- .03 Annually, member firm managing partners and proprietors will be asked to nominate partners and managers, or equivalent supervisory personnel active in the accounting and auditing function, for service on review teams. Each proposed reviewer submits a profile indicating the extent and areas of accounting, auditing, and professional experience, the extent of participation in peer review and quality review programs, and whether a reviewers' training course has been attended. This information is included in the national data bank of reviewers, which is updated annually. Using a computer program that matches the profiles of individuals in the national data bank of reviewers with the requirements of the specific review, the AICPA quality review division staff (**the staff**), under the overall direction of the committee, selects team members and captains.

Firm-on-Firm Reviews

- .04 Annually, managing partners also will be asked to indicate whether their firms would accept engagements to perform peer reviews of other member firms. Firms willing to accept such engagements will be included in a national data bank that is made available to other member firms on request solely for their convenience. It remains the responsibility of the reviewed firm

to determine whether these firms have the qualifications to conduct a review.¹

State CPA Society and Association Reviews

- .05 A list of state CPA societies and associations of CPA firms that have committee-approved plans for arranging and carrying out peer reviews will be maintained. This list will be updated whenever the committee approves a new or updated plan pursuant to the guidelines included in PCPS §3000 and PCPS §4000.

Evaluation of Reviewers

- .06 All reviewed firms will be asked to evaluate the performance of the review team and the effectiveness of the peer review program. In addition, the performance of team captains will be subjected to an evaluation by the peer review committee. Any such evaluation will be communicated to the team captain.²
- .07 At the conclusion of each review by a committee-appointed review team, the team captain will also evaluate the performance of each team member.
- .08 PARAGRAPH DELETED.

Arranging Reviews

- .09 During the last quarter of each year, the staff will contact the managing partners of member firms scheduled to have a review in the following year. Each firm will be asked to advise the staff of the anticipated timing of the review and whether the review is to be performed by a team appointed by the committee, by an authorized state CPA society or association, or by a member firm. Each firm will be advised that the staff must be informed promptly of the firm's arrangements for the review to enable the committee to accomplish its administrative and oversight functions.

¹ In determining a firm's qualifications, a reviewed firm should obtain a copy of the report issued in connection with the potential reviewing firm's most recent peer review, the accompanying letter of comments, and the related letter of response.

² See Appendix C, PCPS §5000.53, "Reviewer's Responsibilities When Performing PCPS Peer Reviews."

Committee-Appointed Review Teams

- .10 The staff will request relevant background information from firms that are scheduled to have a review during the year or that request a review.
- .11 After receipt of the background information, a team captain and team members, if any, will be selected by the staff from the national data bank of reviewers. In selecting reviewers, consideration will be given to their experience with practice units of comparable size and types of practice. Review team members will be asked if they know of any reason why it would be inappropriate for them to participate in the review. Subsequent changes in team members or the addition of consultants to the review team are to be made only by the team captain with the concurrence of the staff.
- .12 The staff will prepare the engagement letter that will include the range of hours anticipated to complete the review and the hourly rate to be charged for each member of the review team. After the engagement letter is prepared it will be sent to the firm for signature. This will ordinarily take place approximately four to six weeks before the review is scheduled to begin. This is usually adequate advance notice, since the review is generally scheduled for the week requested by the firm. A sample engagement letter is shown in Appendix A, PCPS §5000.51.
- .13 In the engagement letter, the reviewed firm will be advised of the names of reviewers and their firms. If there is a conflict of interest, the reviewed firm will have the opportunity to request reconsideration of any proposed team member.
- .14 Generally, reviewers will be selected from outside the state or geographical area in which the reviewed firm practices. However, the reviewed firm may waive this consideration.

Firm-on-Firm Reviews

- .15 If a member firm elects to have a review conducted by another member firm, the reviewed firm must notify the staff prior to the commencement of the review and must submit certain relevant background information. The committee reserves the right to approve the selection of the reviewing firm and the reviewers in any firm-on-firm review, which must be conducted in accordance with PCPS §2000, "Standards for Performing and Reporting on Peer Reviews."

State CPA Society and Association Reviews

- .16 If a member firm elects to have a review arranged and carried out by a state CPA society or an association of CPA firms, the

firm must notify the staff prior to the commencement of the review and must furnish a copy of that notification to the state CPA society or association. The committee reserves the right to approve the selection of reviewers on state CPA society and association reviews.

- .17 The state CPA society or association must have a plan of administration that has been approved by the committee. For guidance, the committee has developed guidelines for involvement by state CPA societies and associations of CPA firms, which are discussed in PCPS §3000 and PCPS §4000. The review must be conducted in accordance with the approved plan of administration and with the standards for performing and reporting on peer reviews.

Performing Reviews

- .18 The standards for performing and reporting on peer reviews indicate that there may be situations that require the review team to consult with the peer review committee or its staff. Examples of such situations are as follows:
- a. The review team is uncertain about the type of report to be issued or the matters to be included in the letter of comments
 - b. Consideration is being given to suspending or terminating the review
 - c. Difficulties are encountered or circumstances appear to require a departure from the peer review standards – for example, in selection of engagements for review
 - d. The review team encounters a situation where it and the reviewed firm disagree about whether there is a need to take action to prevent future reliance on a previously issued report, pursuant to the AICPA Professional Standards, vol. 1, AU section 561
 - e. The review team encounters a situation where it and the reviewed firm disagree about whether there is a need for additional auditing procedures to provide a satisfactory basis for a previously expressed opinion, pursuant to the AICPA Professional Standards, vol. 1, AU section 390
 - f. The review team encounters a situation where it and the reviewed firm disagree about whether the firm had a reasonable basis under the standards for accounting and review services for the report issued

- g. The review team encounters difficulties in selecting a reasonable cross section of the firm's accounting and auditing practice based on the engagement selection criteria set forth in the peer review standards
- .19 If the review team encounters one of the above situations, the team captain should consult with the staff, who, if the matter cannot be resolved, will arrange a consultation with a member of the committee.

Reporting on Reviews

- .20 PCPS §2000.84 of the "Standards for Performing and Reporting on Peer Reviews" provides that, within 30 days of the date of the exit conference, the team captain will submit to the reviewed firm the team's report and letter of comments, if any. The team captain should notify the staff when the review has been completed and the report and letter, if any, have been issued.
- .21 The standards also provide that the reviewed firm will be responsible for submitting to the committee a copy of the report, the letter of comments, and its response thereto within 30 days of the date the report and letter were issued.
- .22 The staff will notify the reviewed firm and team captain by letter that the report and, if applicable, letter of comments and response thereto, have been accepted by the committee and placed in the public file. The reviewed firm should not release copies of the report, letter of comments, or response thereto to its personnel, its clients, or others until it has been advised that these documents have been accepted by the committee.
- .23 A member of the committee or the staff may (before, during, or after the review) make such inquiry into the scope and conduct of the review as is deemed necessary in the circumstances.

Review Team Working Papers

Committee-Appointed Review Teams

- .24 Concurrent with the issuance of the report, which should be within 30 days of the exit conference, the team captain will send the working papers to the AICPA Quality Review Division at the AICPA's New Jersey office by an insured carrier. The files should be segregated as follows and should be sent under separate cover:
 - a. Engagement review checklists, engagement-related "Matter for Further Consideration" forms, and supporting materials relating to individual clients

- b. Remainder of working papers, including office and firm-wide summary review memorandums and summary engagement checklists

All Other Reviews

- .25 Working papers for firm-on-firm reviews will be retained by the reviewing firm. Working papers for state CPA society or association reviews will be retained by the respective state CPA society or association. In all cases, within 30 days of the date of the exit conference, the team captain will send to the AICPA Quality Review Division at the AICPA's New Jersey office copies of the summary review memorandum (including matters incorporated by reference), "Matter For Further Consideration" forms and the team captain's checklist. All working papers will be subject to review by the committee, the staff, and, if applicable, an oversight or evaluation panel. The team captain should notify the staff of when and where the working papers will be available for review.

Retention Period

- .26 All working papers, reports, and letters prepared during a PCPS peer review, with the exception of those described in paragraph .27 below, should be retained by the entity that formed the review team until ninety days after the PCPS peer review committee has issued a letter accepting the peer review report,³ and, if applicable, the letter of comments and the response thereto, unless the committee indicates that the working papers should be retained for a longer period of time as described in paragraph .29 below.
- .27 The following peer review documents should be retained from a peer review until the subsequent review required for continued membership or until the time for such review has elapsed:
 - a. The peer review report.
 - b. The letter of comments and the firm's response thereto, if applicable.

³ If the peer review is intended to meet the requirements of the Federal Deposit Insurance Act, the review team should retain the working papers for a period of 120 days after the date that the reviewed firm files the peer review report, and if applicable, the letter of comments and the response thereto with the Federal Deposit Insurance Corporation (FDIC). The committee recommends that the review team consult with AICPA staff if the FDIC requests access to the peer review working papers.

- c. The letter accepting the peer review report.
 - d. The letter documenting the firm's compliance with actions taken as a result of the committee consideration of the peer review report.
- .28 In addition, the administering entity may also wish to consider retaining the following other materials which relate to the business of the engagement, rather than the peer review itself:
- a. Engagement letters.
 - b. Scheduling information forms.
 - c. Team appointment acceptance letters.
 - d. Extension requests.
- .29 Notwithstanding the above, all working papers should be retained for as long as any of the following are in process:
- a. Resolution of a disagreement between the reviewed firm and the review team.
 - b. A visit by a reviewer to the reviewed firm after a review has been otherwise completed to determine whether appropriate corrective actions have been taken on the deficiencies noted during the peer review.
 - c. Activities of an oversight or evaluation panel assigned to the review engagement.
 - d. The sanction process, including actions by both the peer review committee and the executive committee.
 - e. The appeal of any decision of the peer review committee or the executive committee as long as such appeal was initiated in accordance with rules established by these committees.
 - f. Review by the FDIC staff.

Files

- .30 The section's files will be maintained at the AICPA's New York office, classified as follows:

**Available for
Public Inspection**

The firm's membership application and related documents (for example, waiver

**Not Available for
Public Inspection**

Administrative files
Working papers

(Continued)

**Available for
Public Inspection**

of or extension for compliance with a membership requirement)

The firm's annual reports

Report on peer review

Letter of comments and the reviewed firm's response thereto

Report on review of association quality control materials

Letter of comments resulting from a review of association quality control materials and the response thereto

Report on association or state CPA society administrative reviews

Letter of comments resulting from an association or state CPA society administrative review and the response thereto

Committee letter of acceptance

Information concerning actions taken as a result of committee consideration of the peer review report

Notification of suspension or termination of review, if applicable

Letter of termination

The firm's letter of resignation and the acceptance thereof

**Not Available for
Public Inspection**

Peer review committee recommendations of sanctions to executive committee

Oversight panel's memorandum(s) and related working papers

An organization's request for committee authorization to arrange and carry out a peer review program and the grant thereof

- .31 Information concerning sanctions imposed will be classified as public or nonpublic as determined by the executive committee.
- .32 The firm's annual reports will be retained for three years. Documents relating to a peer review will be retained until completion of the subsequent review or until the time for such review has elapsed. Public files of a firm whose membership has been terminated, either by resignation or by action of the executive committee, will be available for public inspection as long as the firm is included in the current edition of the directory of the AICPA Division for CPA Firms. The directory contains guidance on the requesting of information from the public files.

Suspension or Termination of a Review Prior to Completion

- .33 The standards for performing and reporting on peer reviews provide that a review may not be suspended or terminated without the prior approval of the committee chairman or his designee. They also require that the team captain notify the reviewed firm and the committee in writing of the date and the substantive reasons for the suspension or termination. In some circumstances, however, the committee may wish to inquire further into the reasons for the suspension or termination and to supplement the record with a memorandum of that inquiry. Suspension or termination of a review ordinarily will not be approved when the review team has noted significant deficiencies related to engagements.
- .34 A suspended review will be completed at some later date, using the work already completed and, if available, the same review team. A review may not be suspended for more than six months. No further work will be done on a terminated review, and the reviewed firm must contract for a new review at a later date if it desires to remain in the section.
- .35 The working papers for the suspended review should be retained by the entity that assembled the review team, that is, the AICPA, a reviewing firm, a state CPA society, or an association of CPA firms. When the review is resumed, these working papers should be given to the team captain for use in completing the review. Working papers for terminated reviews should not be retained after the committee has approved the termination.
- .36 When a review is suspended or terminated during its very preliminary stages and no substantive review work is accomplished, a notification letter to the committee is not necessary. However, the team captain must notify the committee's staff that the review is being suspended or terminated and the reasons therefor.

Fees and Expenses**Committee-Appointed Review Teams**

- .37 Fees will be charged at rates established by the committee; such rates are based upon the average standard billing rates of reviewers who have been included in the national data bank of reviewers. The rates are periodically reviewed by the committee to ensure their suitability. The billing rates will vary based on the size of the reviewed firm. (See Appendix B, PCPS §5000.52.)
- .38 Separate rates are established for –
- a. The team captain.
 - b. The review team members who are partners.
 - c. The review team members who are not partners.
- .39 All out-of-pocket expenses, such as those for travel and subsistence, will be billed to the reviewed firm at actual cost. The procedures for submitting bills are as follows:
- a. The team members should submit their bills for time and expenses to the team captain for approval.
 - b. Within 30 days of the date of the exit conference, the captain should submit the approved bills, together with his own, to the AICPA.
- .40 AICPA staff will use this billing information to prepare and submit its bill to the reviewed firm. Scheduling and evaluation fees will be added to cover the costs of administering the program. (See Appendix B, PCPS §5000.52.) These fees also will be deemed to cover the cost of inquiry by committee members or staff into the performance of committee-appointed review teams, but it does not cover the cost of a required revisit by the review team or an accelerated review deemed necessary as a result of the committee's consideration of the report, letter of comments, and the firm's response thereto.

All Other Reviews

- .41 For firm-on-firm reviews and reviews arranged and carried out by authorized state CPA societies or associations of CPA firms, the respective reviewing entities will make their own fee and billing arrangements. In addition, the reviewed firm will be charged for scheduling and evaluation fees to cover the cost of administering the program. (See Appendix B, PCPS §5000.52.)

Evaluation Panels

- .42 The costs related to an evaluation panel will be paid by the private companies practice section.

Evaluating the Review Process

General Considerations

- .43 The committee is responsible for monitoring and evaluating the private companies practice section peer review program. In this regard, the committee may assign one of its members or a member of the staff to make such inquiry into the scope and conduct of the review as is deemed necessary under the circumstances, including a review of working papers. Such inquiry may be made either while the review is in process or after it is completed.

Oversight Panels

- .44 The peer review committee may, at its discretion, appoint an oversight panel of one or more persons to evaluate any peer review conducted for purposes of meeting the section's membership requirements. The objective of an oversight panel is to assist the committee in determining whether a particular peer review was conducted in accordance with the standards for performing and reporting on peer reviews.
- .45 An oversight panel will consider whether the scope and performance of the review in question are in accordance with standards established for such reviews and whether the review team's report conforms to the reporting standards. The panel will also consider the appropriateness of the review team's conclusions and may consult with the team and/or the reviewed firm concerning differences of professional opinion.
- .46 An oversight panel may perform its work concurrently with or after the conclusion of a peer review and issuance of the review team's report.
- .47 Oversight panel members will be appointed by the committee or staff as directed by the committee chairman. The qualifications for panel members are the same as those for team captains. Panel members also must be independent of the reviewed firm and the review team members.
- .48 An oversight panel will report to the committee orally and/or in writing as directed by the committee. The panel's memorandum(s) and related working papers, if any, will be for the information of the committee and will be retained in the nonpublic files.

- .49 If, after the completion of the evaluation, the oversight panel, the reviewed firm, and the team captain all agree with the report originally issued at the conclusion of the review, that report will remain unchanged. If they all agree upon the modifications to be made, a revised report will be issued.
- .50 If the oversight panel, the reviewed firm, and the team captain all do not agree, the matter will be decided by the committee.

.51 APPENDIX A—Sample Engagement Letter

[For a committee-appointed review team]

(Date)

(The Managing Partner's Name)
(Firm Name)
(Address)

Re: Review Number

Dear (Managing Partner's Name):

You have requested us to appoint a reviewer(s) to perform a peer review of your firm's accounting and auditing practice. We are willing to arrange for such an engagement, subject to the terms and conditions set forth in this letter.

The attachment to this letter contains information on the reviewer(s). If any changes need to be made in the reviewer(s), we will notify you immediately and ask you to authorize those changes.

Scope of the Review

The review will be performed in accordance with the Standards for Performing and Reporting on Peer Reviews, issued by the AICPA Private Companies Practice Section Peer Review Committee. Those standards require, among other things, that the review 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 that is obtained as a consequence of the review is confidential. Such information shall not be disclosed by reviewer(s) to anyone not involved in carrying out the review or administering the PCPS peer review program or used in any way not related to meeting the objectives of the peer review program. Also, no reviewer(s) will have contact with clients of your firm.

If it is necessary to obtain the consent of your clients for review of files and records pertaining to them, you will assume the responsibility for obtaining such consent.

Liability and Subpoena

You agree not to take, or assist in, any action seeking to hold liable, jointly or singly, us, or the reviewer(s)—including any staff, assistants, committees, or the reviewer(s) or their firms—for damages on account of any good faith act or omission or on account of any deficiency in the files overall, unless those damages arise from malice, gross negligence, or recklessness, or any violation of the confidentiality standards issued by the AICPA in its Code of

Professional Conduct. Also, you agree not to subpoena any of those persons or organizations, or otherwise call them to testify, in any action to which they are not a party, with respect to any of the work performed, reports made, or information acquired or developed in connection with this review. However, this provision shall not apply if some other person has done that successfully and you conclude you must do so in response.

Timing of Review and Fees

We anticipate that the review will begin on (date of commencement) and take between ____ and ____ hours to complete. However, this is only an estimate and reviewer time will be billed at actual.

The reviewer(s) billing rates are set forth in the attachment. Your firm will also be expected to pay for all reviewer out-of-pocket expenses and the administrative fees established by the American Institute of Certified Public Accountants for the scheduling of the review and the evaluation of the review results. The administrative fee structure is also set forth in an attachment to this letter.

Invoices are due upon presentation. Fifty percent of the professional charges based on the upper range of the budget estimate will be due at least 10 days prior to the commencement of the fieldwork on the review. However, under certain circumstances, other progress bills may also be rendered. A final invoice will be sent to you after the report on your review has been issued. A late charge of 1.5% per month will be assessed on all balances not paid within 90 days.

* * * * *

If you accept these terms and conditions, please sign and return the enclosed copy of this letter. This letter, including the attachments, will then become a contract between you and us.

Sincerely,

We consent to the terms and conditions described in this letter.

Firm To Be Reviewed

Date

By

Position

Administrative Procedures of the Peer Review Program

5017

Name: John Doe, CPA
Member No.: 1000000
Firm Name.: J. Doe & Company
Firm No.: 12345678
Phone No.: (222) 555-7777
Position: Partner
Billing Rate: \$85.00
Years of Accounting
and Auditing Experience: 21
Size of Reviewer's Firm: 11-19
Period Covered by Firm's Last
Review (if any): July 1, 19__ to June 30, 19__
Practice Monitoring Program(s)
to Which the Reviewer's Firm
Currently Belongs: PCPS

Areas of Experience:

Reviews and Compilations
Examinations of Prospective Financial Information
Audits of Personal Financial Statements
Other Audits
Common Interest Realty Associations
Construction Contractors
Franchisors
Leasing Companies
Manufacturing
Not-for-Profit Organizations
Professional Services
Real Estate Brokerage
Real Estate Development
Real Estate Management
Retail Trade
Wholesale Distributors

.52 APPENDIX B—Peer Review Fees**Committee-Appointed Review Teams****Basic Policy**

1. Pursuant to the peer review committee's administrative procedures, the committee establishes rates annually for committee-appointed review teams. Rates are based upon the average standard billing rates of individuals who have indicated an interest in serving on committee-appointed review teams. Out-of-pocket expenses are billed at actual cost.

Reviewer Rates

2. The peer review committee has approved the following hourly rates to be paid to members of committee-appointed review teams:

	<u>Reviewed Firms with 10 or Fewer Professional Staff</u>	<u>Reviewed Firms with More than 10 Professional Staff</u>
Team captain	\$85	\$95
Team members who are partners	\$75	\$85
Team members who are not partners	\$65	\$75

Report Reviews

3. The rate for a report review by a committee-appointed review team is \$250 for the review of one report plus \$150 for each additional report reviewed.

Administrative Fees

4. Administrative fees, established by the American Institute of Certified Public Accountants, are intended to defray the costs of scheduling and evaluating peer reviews. The scheduling fee covers the costs associated with the selection or approval of a review team and the evaluation fee covers the costs associated with the consideration and acceptance of the results of the review. The fees are assessed to firms in the year of their review and charged on all types of reviews, whether carried out by a committee-appointed review team (a "CART" review), another firm (a "Firm-on-Firm" review), or under the auspices of a state CPA society or an association of CPA firms.

5. The administrative fees for reviews performed on or after October 1, 1990 is as follows:

<u>Size of Firm</u>	<u>Scheduling</u>	<u>Evaluation</u>
Sole practitioner with no professional staff	\$ 70	\$200
2 to 10 professionals	\$100	\$250
More than 10 professionals	\$150	\$350
Associations of CPA firms	\$ 25	\$ 75

6. The administrative fees for firms that have a report review are similar to the administrative fee schedule discussed above. However, the aggregate fees for scheduling and evaluation are \$50 lower for a sole practitioner with no professional staff, \$100 lower for a firm with 2 to 10 professionals, and \$200 lower for a firm with more than 10 professionals.

.53 APPENDIX C—Reviewer's Responsibilities When Performing PCPS Peer Reviews

A peer reviewer has a responsibility to perform a peer review in a timely, professional manner. This relates not only to the initial submission to the Quality Review Division of the report, letter of comments 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 that is under the control of the reviewer, or resolving questions raised during the review process by the Peer Review Committee or its staff.

In considering the peer review documents for acceptance, the Committee also 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 over numerous reviews is noted, then the Committee, depending on the particular circumstances, will consider the need for corrective or monitoring actions on the reviewer. The Committee may require the reviewer to comply with certain actions, such as the following, in order to continue performing reviews:

- Attendance at a reviewer's training course and receipt of a satisfactory evaluation from the instructor of the course.
- 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 respective CART team captain billing rate established by the section).
- Completion of all outstanding reviews before accepting an engagement to perform another review.
- Preissuance review of the report, letter of comments, and working papers on future reviews by an individual who has experience in performing peer reviews.

If corrective or monitoring actions are imposed on a reviewer by the SECPS Peer Review Committee or the Quality Review Executive Committee, those actions will also apply to PCPS peer reviews performed by the reviewer unless the actions are specific to the other programs. In addition, any condition imposed on a reviewer will apply to the individual's service as either a team captain or a team member unless the condition specifically relates to the individual's service as only a team captain or team member.

If a reviewer refuses to cooperate with the Committee, fails to correct material performance deficiencies, or is found to be so seriously deficient in his or her performance that education and corrective or monitoring actions are not adequate, the PCPS Peer Review Committee may prohibit the individual from performing PCPS peer reviews in the future. In such situations, the Peer Review Committee will instruct the Quality Review Division to remove the reviewer's name from the list of qualified reviewers.

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

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

Section VI

CONTINUING PROFESSIONAL EDUCATION

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Section

6000 Continuing Professional Education Requirements

PCPS
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Membership Requirements

CONTINUING PROFESSIONAL EDUCATION REQUIREMENTS

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Continuing Professional Education Requirements**Basic Requirement**

- .01 The fundamental purpose of continuing professional education is to help professionals in member firms maintain and/or increase their professional competence. A professional's field of employment does not limit the need for continuing professional education. Therefore, this requirement applies to all professionals in member firms, including CPAs and non-CPAs, who reside in the United States. All such professionals are required to participate in at least 20 hours of qualifying continuing professional education every year and in at least 120 hours every three years.¹ Exceptions to this requirement are set forth in PCPS sections 6000.05-.06 and .08-.10. Compliance with this requirement will be determined annually for the three most recent educational years. Professionals are expected to maintain the high standards of the profession by selecting quality education programs to fulfill their continuing education requirements.
- .02 Persons classified as "professional staff" (including partners) in a member firm's annual report to the Private Companies Practice Section (PCPS) shall be considered "professional" for purposes of these continuing professional education policies. (See PCPS section 1000.07f.(7))
- .03 Each member firm may select any year-long period (educational year) for applying these continuing professional education policies. The educational year may differ from the member firm's fiscal year; however, both periods are to be specified in the annual report filed with the PCPS.² (See PCPS section

¹ Compliance with mandatory continuing professional education requirements for state licensing or for state society membership is deemed to be in compliance with the requirements of the PCPS, provided such state or society requirements call for an average of 40 hours of continuing professional education per year and provided each professional in the firm participates in at least 20 hours of continuing professional education every year.

² When mandatory continuing professional education requirements for state licensing or for state society membership provide that the period to be used for determining compliance with those requirements shall vary by individuals (for example, the period might coincide with the date of the individual's license to practice), such periods may be used for determining whether there was compliance with the PCPS's continuing professional education requirements during the firm's educational year.

(continued)

- 1000.07f.) A change in a member firm's educational year shall be stated in the firm's annual report for the year in which the change is made.
- .04 It is the responsibility of each member firm to ensure that all professionals comply with these continuing professional education requirements. A professional may have to meet continuing professional education requirements of a state licensing body, other governmental entities, a membership association, or other organizations or bodies. If compliance with the mandatory continuing professional education requirements of these bodies is used as a basis for compliance with the PCPS requirements, it is the responsibility of the member firm to ensure that these requirements are met.
- .05 Exceptions to the PCPS continuing professional education requirements can be made for reasons of health, military service, foreign residency, retirement, or other good reason if such reason prohibits compliance with the requirements. A firm should be prepared to justify any exceptions made.
- .06 The following PCPS requirements apply to those professionals who were not employed by the member firm during the entire most recent three educational years:
- a. Professionals who were not employed during the entire most recent educational year are not required to have participated in any continuing professional education.
 - b. Professionals who were employed during the entire most recent educational year, but not during the entire most recent two educational years, are required to have participated in at least 20 hours of qualifying continuing professional education during the most recent educational year.
 - c. Professionals who were employed during the entire most recent two educational years, but not during the entire most recent three educational years, are required to have participated in at least 20 hours of qualifying continuing

²(continued)

Additionally, firms with offices in more than one state that are required to employ different periods in each state for maintaining compliance with continuing professional education requirements are deemed to be in compliance with the PCPS's requirements.

professional education during each of the two most recent educational years.³

- .07 Any professional who has not participated in the required number of continuing professional education hours during any education year shall have the two months immediately following that period to make up the deficiency. Any continuing professional education hours claimed during the two-month period to make up a deficiency may not also be counted toward the 20-hour requirement of the educational year in which they are taken. Further, any continuing professional education hours claimed during the two-month period to make up any deficiency for the preceding three educational years may not also be counted toward the 120-hour requirement of any three-educational-year period that does not include at least one year of the three-educational-year period for which the deficiency was made up.

Effective Date and Transition

- .08 Except as stated below, a member firm shall be subject to these policies as of the beginning of its first full educational year. For each member firm, this educational year shall begin during the first twelve months after it becomes a member of the PCPS. For example, if a firm joins the PCPS on January 1992 and elects an educational year ending in June that firm must be in compliance with the continuing professional education requirements of the PCPS for its educational year ended June 1993.
- .09 During a member firm's first two educational years, all professionals must participate in at least 20 hours of continuing professional education each year, except as provided in section PCPS 6000.06.
- .10 During a member firm's first five educational years, it need only maintain or retain the continuing professional education records, data, or evidence of attendance or completion referred to in PCPS sections 6000.28-.32 since the beginning of the member firm's first educational year.

³ Member firms have a responsibility to adopt policies and procedures that provide reasonable assurance that all professional personnel are properly trained. The nature and extent of training needed by part-time personnel depend on a number of factors, including the type of work they perform, the degree of supervision they receive, and the number of hours they work. A firm should be prepared to justify any decision not to require a part-time professional to participate in the required number of continuing professional education hours.

Qualifying Programs

- .11 A person performing services of a professional nature needs to have a broad range of knowledge, skills, and abilities. Thus, the concept of professional competence should be interpreted broadly. Accordingly, programs contributing to the development and maintenance of nontechnical professional skills should also be recognized as acceptable continuing education.
- .12 Acceptable subjects include the fields of study set forth in the AICPA National CPE Curriculum: accounting and auditing, advisory services, specialized knowledge and applications, management, personal development, and taxation. Other subjects may also be acceptable if they maintain and/or increase the professional's competence.
- .13 While professionals participate in a wide variety of learning activities, continuing professional education credit is allowed only for formal programs of learning that maintain or increase the professional competence of the individual. A formal program of learning is a process that is designed and intended primarily as an educational activity and complies with the requirements of the PCPS. All other competence-building and learning activities are considered to be informal. Even though no credit is allowed for informal learning activities, these learning activities are very important in attaining and maintaining professional competence, and they are a regular part of a professional's continuing development.
- .14 Attendance at the following group programs will qualify **only** if the program is designed and intended primarily as an educational activity and complies with the continuing professional education requirements of the PCPS:
 - a. Professional education and development programs of national, state and local accounting organizations
 - b. Technical sessions at meetings of national, state and local accounting organizations and their chapters
 - c. University or college courses (both credit and non-credit)
 - d. In-firm education programs
 - e. Programs of other organizations (accounting, industrial, professional, etc.)
 - f. Professional society and committee meetings

- g. Dinner, luncheon and breakfast meetings
 - h. Firm meetings for staff and/or management groups
- .15 Portions of the foregoing meetings devoted to administrative and firm matters often do not qualify for continuing professional education credit. For example, portions devoted to the communication and application of a professional policy or procedure may qualify. However, portions devoted to member firm's financial and operating matters generally would not qualify.
- .16 The following also qualify for continuing professional education credit:
- a. Self-study programs (interactive and non-interactive) that comply with the requirements of the PCPS
 - b. Service as an instructor or discussion leader at a continuing professional education program (both preparation and presentation time) if the program increases professional competence and qualifies for credit for participants
 - c. Publication of articles, books or continuing professional education programs
- .17 An interactive self-study program is a program designed to use interactive learning methodologies that simulate a classroom learning process by employing software, other courseware or administrative systems that provide significant ongoing, interactive feedback to the learner regarding his or her learning progress. Evidence of satisfactory completion of each program segment by the learner is often built into such programs. These programs clearly define lesson objectives and manage the student through the learning process by (1) requiring frequent student response to questions that test for understanding of the material presented, (2) providing evaluative feedback to incorrectly answered questions, and (3) providing reinforcement feedback to correctly answered questions. Therefore, capabilities are used that, based on student response, provide appropriate ongoing feedback to the student regarding his or her learning progress through the program.
- .18 A non-interactive self-study program is any self-study program that does not meet the above criteria for interactive self-study programs.

Requirements for Formal Continuing Professional Education Program Measurement

- .19 All programs should be measured in 50-minute contact hours. The shortest program for credit should consist of one contact hour. The purpose of this standard is to develop uniformity in the measurement of formal programs. A contact hour is 50 minutes of participation in a group program. Under this standard, credit is granted only for full contact hours. For example, a group program lasting 100 minutes would count for two contact hours; however, one lasting between 50 and 100 minutes would count for one contact hour. For programs in which individual segments are less than 50 minutes, the sum of the segments should be considered one total program. For example, five 30-minute presentations would equal 150 minutes and should be counted as three contact hours.
- .20 Sponsors are encouraged to monitor group programs in order to accurately record the appropriate number of contact hours for participants who arrive late or leave before a program is completed.
- .21 Self-study programs should be pre-tested to determine the average completion time. Interactive self-study programs should receive credit equal to the average completion time. Non-interactive self-study programs should receive credit equal to one-half of the average completion time. For example, an interactive self-study program that takes an average of 800 minutes to complete should be recommended for 16 contact hours of credit. A non-interactive self-study program that takes an average of 800 minutes to complete should be recommended for eight contact hours of credit. Developers should keep appropriate records of how the average completion time was determined.
- .22 For university or college courses that meet the continuing professional education requirements, each unit of credit shall equal the following contact hours:
- | | |
|--------------------|----------|
| a. Semester System | 15 hours |
| b. Quarter System | 10 hours |
- .23 Contact hours for non-credit university or college courses shall be based on actual time spent in class.
- .24 Instructors or discussion leaders should be given credit for their preparation and presentation time if the programs increase their professional competence and qualify for credit for participants. Credit for instructors or discussion leaders should be measured in contact hours.

- .25 Instructors and discussion leaders should receive credit for both preparation and presentation. The first time they present a program, they should receive credit for actual preparation hours up to two times the number of presentation hours. For example, if a program is presented for eight contact hours, the instructors could receive up to 24 contact hours of credit (16 contact hours for preparation and eight contact hours for presentation). For repeat presentations, instructors should receive no credit unless they can demonstrate that the program content involved was substantially changed, and such change required significant additional study or research.
- .26 The maximum credit for preparation and presentation should not exceed 50 percent of the total credit required in a reporting period. For example, if an instructor's requirement is 120 contact hours during a three year educational period, the maximum credit that could be applied to meet the requirements of the PCPS would be 60 contact hours, even if 24 contact hours of presentation and up to 48 contact hours of preparation were earned during that period.
- .27 Writers of published articles, books, or continuing professional education programs should be given credit for their research and writing time if this time increases their professional competence. Credit for writers should be measured in contact hours. Writing articles, books, or education programs for publication is a structured activity that involves a formal process of learning. For the writer to receive credit, the article, book, or program must be formally reviewed and published by a publisher not under the control of the writer. Credit from this activity should be limited to 30 contact hours during any three year educational period.

Requirements for Formal Continuing Professional Education Program Reporting

- .28 Except as provided in PCPS sections 6000.08-.10, each member firm must maintain appropriate records for each professional for its most recent five educational years. These records should contain the following information for each continuing professional education activity for which credit is claimed for the individual:
 - a. Sponsoring organization
 - b. Title of program and description of content
 - c. Date(s) attended or completed
 - d. Location of program (city/state)

Continuing Professional Education Requirements

- e. Number of continuing professional education contact hours
 - f. Appropriate evidence of completion
- .29 Acceptable evidence of completion includes:
- a. For group programs, a certificate or other verification supplied by the sponsor
 - b. For a university or college course that is successfully completed for credit, a record of the grade the person received; for a non-credit course, a record of attendance and completion
 - c. For self-study programs, a certificate supplied by the sponsor after satisfactory completion of a workbook or examination
 - d. For instruction credit, evidence obtained from the sponsor of having been the instructor or discussion leader at a program
 - e. For published articles, books, or continuing professional education programs, evidence of publication
- .30 Except as provided in PCPS sections 6000.08-.10, each member firm must retain for at least five educational years the following information for programs it sponsors:
- a. Record of participation
 - b. Copy of the program materials
 - c. Date(s)
 - d. Location(s) of the program (city/state)
 - e. Instructor(s)
 - f. Number of contact hours
 - g. Summary of program evaluations
 - h. Evidence of compliance with responsibilities set out under these requirements
- .31 The appropriate amount of time for retention of this information is not dependent solely on the location of the program or sponsor. Therefore, sponsors should retain this infor-

mation for a period of five years from the date the program is completed.

- .32 Sponsors may wish to provide a certificate or other verification to participants; in any event, sponsors should be prepared to furnish, upon request, a record of participation to participants. The record should reflect the credit hours earned by each participant, including those who arrived late or left early.

Requirements for Formal Continuing Professional Education Program Development and Presentation

- .33 Continuing professional education sponsors have a responsibility to comply with all applicable continuing professional education requirements. Sound administration, adequate resources, competent supervision and an effective and supportive organizational structure are necessary elements in the design, development, implementation and monitoring of continuing professional education programs. For each program sponsor, there should be an identifiable administrator charged with demonstrating compliance with these requirements.
- .34 When a sponsor works with others to develop, distribute, and/or present continuing professional education programs, the responsibility for ensuring that all requirements are met rests with the sponsor. The functions of each party should be identified and documented.

Development

- .35 Program developers should state learning objectives and specify the level of knowledge of the program. Learning objectives should specify what participants will be able to perform upon completing a program. A program may have more than one objective, but each objective should be written to be consistent with the program's specified level of knowledge. Levels of knowledge could be described as:
 - a. Basic—Covers fundamental principles and skills. This level is for individuals with limited or no exposure to the subject(s).
 - b. Intermediate—Builds on the basic level or upon fundamental principles and skills and focuses on their application. The level is for individuals with some exposure to the subject(s).
 - c. Advanced—Focuses on the development of in-depth knowledge, a variety of skills and/or a broader range of

application. This level is for individuals with significant exposure to the subject(s).

- d. Update—Provides a general overview of new developments. It is for individuals with a background in the subject(s) who wish to be kept up-to-date.
- .36 Program developers should state the prerequisites for education, experience or both for all programs. Prerequisites should be written in precise language so that potential participants can readily ascertain whether they qualify for the program or whether the program's specified level of knowledge is appropriate for them.
 - .37 Program developers should be qualified in the subject matter and be knowledgeable in instructional design. Qualification in subject matter and a knowledge of instructional design may be obtained through appropriate practical experience or education or both. The level of technical competence and instructional design skills that the developer(s) should possess will vary depending on certain characteristics of the program, such as the number of times it will be presented, the length of the program, the complexity of the subject matter and the number of participants.
 - .38 Program materials should be technically accurate, current, and sufficient to meet the program's learning objectives and should be reviewed periodically to ensure compliance with this requirement.
 - .39 Program materials should be reviewed, to the extent necessary, before the materials are used, by a qualified person or persons other than the person(s) who developed them, in order to assure the program's technical accuracy, currency and sufficiency to achieve the learning objectives. In order to meet this standard, the program materials must be prepared in advance of presentation. The nature and extent of review will vary depending on the characteristics of programs. If a review is considered appropriate, the level of technical competence and instructional design knowledge of a reviewer should be at least equal to those of the program developer(s).

Presentation

- .40 Program sponsors should inform participants in advance of learning objectives, prerequisites, level of knowledge of the program, program content, nature and extent of advance preparation, teaching method(s) to be used, recommended continuing professional education credit and relevant administrative policies.

- .41 In order for potential participants to effectively plan their continuing professional education, the significant features of the program should be disclosed in advance in brochures or other announcements. When programs are offered in conjunction with non-educational activities, or when several programs are offered concurrently, an appropriate schedule of events indicating those components that are recommended for continuing professional education credit should be made available to participants. The sponsor's registration policies and procedures should be formalized, published and made available to participants.
- .42 Program sponsors should encourage participation only by individuals with appropriate education, experience or both. Sponsors should comply with the spirit of this standard by encouraging:
 - a. Enrollment only by eligible participants
 - b. Timely distribution of materials
 - c. Completion of any advance preparation by participants
- .43 Program sponsors should select instructors qualified with respect to both program content and teaching methods used. The instructor is a key ingredient in the learning process in any group program. Therefore, it is imperative that sponsors exercise great care in selecting qualified instructors for all group programs. Qualified instructors are those who are capable, through background, training, education and/or experience, of communicating effectively and providing an environment conducive to learning. They should be competent in the subject matter, skilled in the use of the appropriate teaching method(s) and prepared in advance. Instructors are responsible for informing participants of any changes necessary to make the program current.
- .44 Sponsors should evaluate instructors' performance at the conclusion of each program to determine their suitability to continue to serve as instructors.
- .45 Program sponsors should ensure that the number of participants and physical facilities are appropriate for the teaching method(s) specified by the developer. The number of participants, quality of facilities, and seating arrangements are integral aspects of the educational environment and should be carefully controlled.
- .46 Program sponsors should provide an effective means for evaluating the quality of the program. The objective of evaluations

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Continuing Professional Education Requirements

is to increase program effectiveness. Evaluations should be solicited from both participants and instructors.

- .47 At a minimum, programs should be evaluated to determine whether:
 - a. Learning objectives have been met
 - b. Prerequisites were necessary or desirable
 - c. Program materials contributed to the achievement of the learning objectives
 - d. The program content was timely and relevant
- .48 In addition, group programs should be evaluated to determine whether:
 - a. The instructor's knowledge and presentation skills were effective
 - b. Facilities were satisfactory
- .49 Evaluations might include questionnaires completed after a program, oral feedback from participants or tests for the effectiveness of a program. Sponsors should periodically review the evaluation process to ensure its effectiveness.

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APPENDIXES

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APPENDIX A

Statement on Quality Control Standards 1

Issued by the Quality Control Standards Committee
November 1979

System of Quality Control for a CPA Firm

(This statement provides that a CPA firm shall have a system of quality control and describes elements of quality control and other matters essential to the effective implementation of the system.)

1. Quality control for a CPA firm, as referred to in this statement, applies to all auditing and accounting and review services for which professional standards have been established.¹ Although the provisions of this statement may be applied to other segments of a firm's practice, such as providing tax services or management advisory services, their applicability to those segments of practice is not prescribed by this statement, except to the extent that such services are a part of the abovementioned auditing and accounting and review services.
2. In providing professional services, a firm has a responsibility to conform with professional standards. In accepting this responsibility, there is a presumption that the firm will consider the integrity of individuals in determining its professional relationships, that the firm and its people will be independent of its clients to the extent required by the AICPA's rules of conduct, and that the firm's personnel will be professionally competent, will be objective, and will

¹ Firm is defined in the AICPA rules of conduct as "a proprietorship, partnership, or professional corporation or association engaged in the practice of public accounting, including individual partners or shareholders thereof." Professional standards, as referred to in this statement, are those that relate to the professional qualities and performance of individual members of the AICPA and, accordingly, include the rules of conduct of the AICPA, pronouncements of the AICPA Auditing Standards Board and its predecessor committees, and pronouncements of the AICPA Accounting and Review Services Committee.

exercise due professional care.² To provide itself with reasonable assurance of meeting its responsibility to provide professional services that conform with professional standards, a firm shall have a system of quality control.

System of Quality Control

3. A system of quality control for a firm encompasses the firm's organizational structure and the policies adopted and procedures established to provide the firm with reasonable assurance of conforming with professional standards. The system of quality control should be appropriately comprehensive and suitably designed in relation to the firm's organizational structure, its policies, and the nature of its practice.
4. Any system of quality control has inherent limitations that can reduce its effectiveness. Variance in individual performance and understanding of professional requirements affects the degree of compliance with a firm's prescribed quality control policies and procedures and, therefore, the effectiveness of the system.
5. The system of quality control for a U.S. firm should provide the firm with reasonable assurance that the segments of the firm's engagements performed by its foreign offices or by its domestic or foreign affiliates or correspondents are performed in accordance with professional standards in the United States.³

Establishment of Quality Control Policies and Procedures

6. 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

² Unless the text states otherwise, the term personnel encompasses all of a firm's professionals performing services to which this statement applies and includes proprietors, partners, principals, and stockholders or officers of professional corporations, and their professional employees.

³ SAS No. 1, AU section 543, provides guidance regarding procedures to be considered on individual audit engagements when the principal auditor utilizes the work of other auditors.

organization, and appropriate cost-benefit considerations.⁴

7. A firm shall consider each of the elements of quality control discussed below, to the extent applicable to its practice, in establishing its quality control policies and procedures. The elements of quality control are interrelated. Thus, a firm's hiring practices affect its policies as to training. Training practices affect policies as to promotion. Practices in both categories affect policies as to supervision. Practices as to supervision, in turn, affect policies as to training and promotion.
 - a. **Independence.** Policies and procedures should be established to provide the firm with reasonable assurance that persons at all organizational levels maintain independence to the extent required by the rules of conduct of the AICPA. Rule 101 of the rules of conduct contains examples of instances wherein a firm's independence will be considered to be impaired.
 - b. **Assigning Personnel to Engagements.** Policies and procedures for assigning personnel to engagements should be established to provide the firm with reasonable assurance that work will be performed by persons having the degree of technical training and proficiency required in the circumstances. In making assignments, the nature and extent of supervision to be provided should be taken into account. Generally, the more able and experienced the personnel assigned to a particular engagement, the less is the need for direct supervision.
 - c. **Consultation.** Policies and procedures for consultation should be established to provide the firm with reasonable assurance that personnel will seek assistance, to the extent required, from persons having appropriate levels of knowledge, competence, judgment, and authority. The nature of the arrangements for consultation will depend on a number of factors, including the size of the firm and the levels of knowledge, competence, and judgment possessed by the persons performing the work.

⁴ The Guide to Implement the Voluntary Quality Control Review Program for CPA Firms—Quality Control Policies and Procedures for Participating CPA Firms, which has been issued by the AICPA under the voluntary quality control review program for CPA firms, may be useful to a firm in considering its quality control policies and procedures.

- d. **Supervision.** Policies and procedures for the conduct and supervision of work at all organizational levels should be established to provide the firm with reasonable assurance that the work performed meets the firm's standards of quality. The extent of supervision and review appropriate in a given instance depends on many factors, including the complexity of the subject matter, the qualifications of the persons performing the work, and the extent of consultation available and used. The responsibility of a firm for establishing procedures for supervision is distinct from the responsibility of individuals to adequately plan and supervise the work on a particular engagement.
- e. **Hiring.** Policies and procedures for hiring should be established to provide the firm with reasonable assurance that those employed possess the appropriate characteristics to enable them to perform competently. The quality of a firm's work ultimately depends on the integrity, competence, and motivation of personnel who perform and supervise the work. Thus, a firm's recruiting programs are factors in maintaining such quality.
- f. **Professional Development.** Policies and procedures for professional development should be established to provide the firm with reasonable assurance that personnel will have the knowledge required to enable them to fulfill responsibilities assigned. Continuing professional education and training activities enable a firm to provide personnel with the knowledge required to fulfill responsibilities assigned to them and to progress within the firm.
- g. **Advancement.** Policies and procedures for advancing personnel should be established to provide the firm with reasonable assurance that those selected for advancement will have the qualifications necessary for fulfillment of the responsibilities they will be called on to assume. Practices in advancing personnel have important implications for the quality of a firm's work. Qualifications that personnel selected for advancement should possess include, but are not limited to, character, intelligence, judgment, and motivation.
- h. **Acceptance and Continuance of Clients.** Policies and procedures should be established for deciding whether to accept or continue a client in order to minimize the likelihood of association with a client whose management

lacks integrity. Suggesting that there should be procedures for this purpose does not imply that a firm vouches for the integrity or reliability of a client, nor does it imply that a firm has a duty to anyone but itself with respect to the acceptance, rejection, or retention of clients. However, prudence suggests that a firm be selective in determining its professional relationships.

1. **Inspection.** Policies and procedures for inspection should be established to provide the firm with reasonable assurance that the procedures relating to the other elements of quality control are being effectively applied. Procedures for inspection may be developed and performed by individuals acting on behalf of the firm's management. The type of inspection procedures used will depend on the controls established by the firm and the assignment of responsibilities within the firm to implement its quality control policies and procedures.

Assignment of Responsibilities

8. A firm shall assign responsibilities to its personnel to the extent required to effectively implement its quality control policies and procedures. In the assignment of responsibilities, appropriate consideration should be given to the competence of the individuals, the authority delegated to them, and the extent of supervision provided.

Communication

9. A firm shall communicate to its personnel its quality control policies and procedures in a manner that will provide reasonable assurance that such policies and procedures are understood. The form and extent of such communication should be sufficiently comprehensive to provide the firm's personnel with information concerning the quality control policies and procedures applicable to them. Although communication ordinarily is enhanced if the communication is in writing, the effectiveness of a firm's system of quality control is not necessarily impaired by the absence of documentation of established quality control policies and procedures. The size, structure, and nature of practice of the firm should be considered in determining whether documentation of quality control policies and procedures is required and, if so, the extent of such documentation. Normally, documentation of quality control policies and procedures would be expected to be more extensive in a larger firm than in a smaller firm and more extensive in a multi-office firm than in a single-office firm.

Monitoring

10. A firm shall monitor the effectiveness of its system of quality control by evaluating on a timely basis its quality control policies and procedures, assignment of responsibilities, and communication of policies and procedures. The size, structure, and nature of practice of a firm influence both the requirements and the limitations of its monitoring function. Implicit in the monitoring function is timely modification of policies and procedures, assignment of responsibilities, and the form and extent of communication, as required by new authoritative pronouncements or by other changes in circumstances, including those resulting from expansion of practice or opening of offices, merging of firms, or acquiring of practices. Monitoring activities include, but are not limited to, the quality control element of inspection.

Quality Control Standards Committee (1978-79)

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Note: This statement on quality control standards was issued by the Quality Control Standards Committee, the senior technical committee of the Institute then designated to issue pronouncements on quality control standards. Firms that are members of the AICPA Division for CPA Firms are obligated to adhere to quality control standards promulgated by the Institute. All AICPA members should be aware that they may be called upon to justify departures from this statement.

APPENDIX B

Interpretations of Quality Control Standards

The following interpretations have been issued by the AICPA Quality Control Standards Committee. Reference should be made to the original pronouncement for the text of the qualified assents of certain members to Interpretation 2.

1. The Relationship Between Inspection and Monitoring

- .01 Question. What is the relationship between inspection and monitoring?
- .02 Interpretation. The objective of monitoring is to determine on a timely basis that the firm's quality control policies and procedures, assignment of responsibilities, and communication of policies and procedures continue to be appropriate. The objective of inspection is to determine compliance with quality control policies and procedures in effect during a period of time. Inspection procedures contribute to the monitoring function because findings, which may indicate the need to modify quality control policies or procedures, are evaluated and changes are considered. Other events such as new authoritative pronouncements or other changes in circumstances, including those resulting from expansion of practice or opening of offices, mergers of firms, acquiring of practices, or separations of significant portions of a firm or its key personnel, may also indicate a need for change in quality control policies and procedures.

[Issue Date: July 1980]

2. Implementation of Inspection In CPA Firms

- .01 Statement on Quality Control Standards 1 indicates that "policies and procedures for inspection should be established to provide the firm with reasonable assurance that the procedures relating to the other elements of quality control are being effectively applied. Procedures for inspection may be developed and performed by individuals acting on behalf of the firm's management. The type of inspection procedures used will depend on the controls established by the firm and the assignment of responsibilities within the firm to implement its quality control policies and procedures." Additionally, the guide Quality Control Policies and Procedures for CPA Firms: Establishing Quality Control Policies and Procedures offers examples of how to implement quality control policies and procedures for the element of inspection.

- .02 Question. How is inspection implemented?
- .03 Interpretation. Inspection is implemented by performing the following at least each year:
- a. Review administrative and personnel files to determine whether there is reasonable assurance that the firm's quality control policies and procedures are being complied with.
 - b. Review engagement working papers, files, and reports to determine whether there is reasonable assurance that the firm's quality control policies and procedures and professional standards are being complied with.
- .04 Inspection procedures should be applied to the extent necessary to provide the firm with reasonable assurance that its quality control policies and procedures are being complied with. Thus, inspection procedures should be applied to each element of quality control and may be on a test basis.
- .05 The performance of inspection procedures may result in information useful in performing the monitoring function.
- .06 Inspection findings should be considered by appropriate firm management personnel. The firm should implement appropriate action as a result of inspection findings and should follow up to determine that planned actions were taken.
- .07 A firm's inspection policies and procedures may provide that a peer review conducted under the AICPA Division for CPA Firms fulfills the firm's annual inspection requirements for the year covered by the peer review. However, standards for performing peer reviews issued by the SEC and private companies practice sections of the AICPA Division for CPA Firms provide that the scope of the peer review may be affected by the review team's

evaluation of the scope and adequacy of the firm's inspection program.¹

- .08 Question. Does the element of inspection apply to all CPA firms, including sole practitioners, with or without professional staff?
- .09 Interpretation. The element of inspection applies to all CPA firms, including sole practitioners, with or without professional staff.
- .10 Question. How can inspection be implemented in sole practitioner CPA firms?
- .11 Interpretation. Statement on Quality Control Standards 1 indicates that the type of inspection procedures used will depend on the controls established by the firm and the assignment of responsibilities within the firm to implement its quality control policies and procedures. It further indicates that procedures for inspection may be developed and performed by individuals acting on behalf of the firm's management. Such individuals may be members of the sole practitioner's professional staff or may be from outside the firm.
- .12 A sole practitioner with or without professional staff may inspect his firm's compliance with his own policies and procedures. In performing such inspection procedures the practitioner may utilize checklists developed by the AICPA or other relevant materials.

¹ The "Standards for Performing and Reporting on Peer Reviews," issued by the peer review committee of the private companies practice section, provide that a peer review must include a review of compliance with the firm's quality control policies and procedures for inspection. The peer review committee has indicated that a failure to perform adequate inspection procedures should be reported in the letter of comments if the other findings on the peer review should have been detected if the firm had performed adequate inspection procedures. If the other findings on the review are significant and should have been detected if the firm had performed adequate inspection procedures, then such failure should ordinarily result in a modified report. Other "significant findings" means 1) one or more findings which result in a modified report, or 2) one or more findings that do not individually result in a modified report, but in the aggregate indicate a serious deficiency in the firm's quality control system or compliance with that system.

- .13 Alternatively, sole practitioner CPA firms with or without professional staff may engage a qualified individual or firm to perform inspection procedures. Two firms, including sole practitioners, may provide inspection procedures for one another.
- .14 Question. How can inspection be implemented in other CPA firms that do not have internal personnel other than those responsible for the functional areas (elements of quality control) or engagements to perform inspection procedures?
- .15 Interpretation. Such firms may employ the same procedures as set forth above for sole practitioners with or without professional staff.
- .16 Question. Are there circumstances under which preissuance engagement review procedures may be considered part of the firm's inspection program?
- .17 Interpretation. The engagement partner's review of working papers, files, and reports does not constitute inspection. However, if a firm uses the supervision procedure of a second management-level preissuance review of engagement working papers, files, and reports, such procedures may compensate for certain post-issuance inspection procedures, and, therefore, could substitute for a part of the firm's inspection program. Such review should be the equivalent of the review the firm would have performed as an inspection procedure after issuance of the report to determine compliance with quality control policies and procedures and professional standards. Findings as a result of such reviews, since they should be equivalent to inspection findings, should be periodically summarized and considered by appropriate firm management personnel. The firm should implement appropriate action as a result of such findings and should follow up to determine that planned actions were taken. The firm would additionally need to review compliance with respect to each element of its quality control system at least each year.

[Issue Date: July 1980]

3. Documentation of Compliance With a System of Quality Control

- .01 Question. In connection with the element of inspection, the AICPA Quality Control Standards Committee has been asked to clarify paragraph 7(i) of Statement on Quality Control Standards 1 as to whether and to what extent documentation would ordinarily be required "to provide the firm with reasonable assurance that the procedures relating to the other elements of quality control are being effectively applied."
- .02 Interpretation. Statement on Quality Control Standards 1 states: "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." Although Statement on Quality Control Standards 1 does not specifically refer to documentation of compliance, a firm ordinarily should require the preparation and maintenance of appropriate documentation to demonstrate compliance with its policies and procedures for the elements of quality control discussed in Statement on Quality Control Standards 1. The form and extent of such documentation depend on a number of factors, such as the size of a firm, the degree of operating autonomy allowed its personnel and its practice offices, the nature of its practice, its organization, and appropriate cost-benefit considerations. However, documentation should be sufficient to enable those conducting an inspection to ascertain the extent of a firm's compliance with its system of quality control, including its compliance with inspection policies and procedures.

[Issue Date: June 1982]

Quality Control Standards Committee (1979-1980)

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Note: These interpretations of quality control standards were issued by the Quality Control Standards Committee, the senior technical committee of the Institute then designated to issue pronouncements on quality control standards. Interpretations do not have the authority of statements on quality control standards issued by the AICPA Quality Control Standards Committee. However, members of the AICPA and member firms of the AICPA Division for CPA Firms should be aware that they may be called upon to justify departures from interpretations.

APPENDIX C

**Quality Control Policies and Procedures for CPA Firms—
Establishing Quality Control Policies and Procedures**

Issued by the Quality Control Standards Committee

Introduction

1. A system of quality control for a CPA firm, as described in Statement on Quality Control Standards 1, encompasses quality control policies and procedures, assignment of responsibilities, communication, and monitoring. This guide provides guidance for the establishment of quality control policies and procedures in accordance with paragraphs 6 and 7 of Statement on Quality Control Standards 1, System of Quality Control for a CPA Firm.
2. Those paragraphs provide 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.
3. A firm shall consider each of the elements of quality control, to the extent applicable to its practice, in establishing its quality control policies and procedures. Certain of the elements of quality control are interrelated. Thus, a firm's hiring practices affect its policies as to training. Training practices affect policies as to promotion. Practices in both categories affect policies as to supervision. Practices as to supervision, in turn, affect policies as to training and promotion.
4. The terms firm, professional standards, and personnel, as used in this guide, are defined in Statement on Quality Control Standards 1. The term policies refers to a CPA firm's objectives and goals for effecting the elements of quality control. Procedures refers to the steps to be taken to accomplish the policies adopted.
5. The elements of quality control are identified in Statement on Quality Control Standards 1 and are discussed in this document under the following designations:
 - a. Independence
 - b. Assigning Personnel to Engagements
 - c. Consultation
 - d. Supervision

- e. Hiring
 - f. Professional Development
 - g. Advancement
 - h. Acceptance and Continuance of Clients
 - i. Inspection
6. A firm should consider establishing policies in the areas identified under each element of quality control discussed herein to the extent such policies are applicable to its practice.
 7. Illustrative examples of procedures designed to implement the policies adopted are also presented. The specific procedures used by a firm would not necessarily include all those illustrated or be limited to them.
 8. Some regulatory agencies have promulgated requirements for compliance with independence or other standards that are applicable to professionals practicing before them. Therefore, a firm should adopt policies and procedures to provide reasonable assurance of compliance with the requirements of the regulatory agencies before which it practices.
 9. When firms merge or when a firm acquires a practice, the combined firm should give special attention to quality control considerations. The combined firm's quality control policies and procedures should be evaluated to determine that they continue to be applicable in light of the changed circumstances. Similar attention should be given to quality control considerations when a firm is divided.

Independence

10. Policies and procedures should be established to provide the firm with reasonable assurance that persons at all organizational levels maintain independence to the extent required by the rules of conduct of the AICPA. Rule 101 of the rules of conduct contains examples of instances wherein a firm's independence will be considered to be impaired.

Policies and Procedures

11. A firm should give consideration to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

- a. Require that personnel at all organizational levels adhere to the independence rules, regulations, interpretations, and rulings of the AICPA, state CPA society, state board of accountancy, state statute, and, if applicable, the Securities and Exchange Commission and other regulatory agencies.¹
 1. Designate an individual or group to provide guidance and to resolve questions on independence matters.
 - (i) Identify circumstances where documentation of the resolution of questions would be appropriate.
 - (ii) Require consultation with authoritative sources when considered necessary.
- b. Communicate policies and procedures relating to independence to personnel at all organizational levels.
 1. Inform personnel of the firm's independence policies and procedures and advise them that they are expected to be familiar with these policies and procedures.
 2. Emphasize independence of mental attitude in training programs and in supervision and review of engagements.
 3. Apprise personnel on a timely basis of those entities to which independence policies apply.
 - (i) Prepare and maintain for independence purposes a list of the firm's clients and of other entities (client's affiliates, parents, associates, and so forth) to which independence policies apply.
 - (ii) Make the list available to personnel (including personnel new to the firm or to an office) who need it to determine their independence.
 - (iii) Establish procedures to notify personnel of changes in the list.

¹ In some cases, a firm may wish to establish other requirements that it deems appropriate, for example, concerning prohibited transactions or relationships.

4. Maintain a library or other facility containing professional, regulatory, and firm literature relating to independence matters.
- c. Confirm, when acting as principal auditor, the independence of another firm engaged to perform segments of an engagement.²
1. Inform personnel about the form and content of an independence representation that is to be obtained from a firm that has been engaged to perform segments of an engagement.
 2. Advise personnel about the frequency with which a representation should be obtained from an affiliate or associate firm for a repeat engagement.
- d. Monitor compliance with policies and procedures relating to independence.
1. Obtain from personnel periodic, written representations, normally on an annual basis, stating that—
 - (i) They are familiar with the firm's independence policies and procedures.
 - (ii) Prohibited investments are not held and were not held during the period. As an alternative or additional procedure, a firm may obtain listings of investments and securities transactions (numbers of shares or dollar amounts need not be included) from personnel to determine that there are no prohibited holdings.

² If a firm utilizes the services of a related, affiliated, or associated firm, the principal firm may obtain periodically (normally annually) a representation from the other firm covering all referred engagements or may include the representation as part of a continuing agreement.

If a firm other than an affiliate or associate is retained, representation should be received for each engagement.

In the case of an international engagement, the representation from the foreign firm should make reference to U.S. independence standards.

- (iii) Prohibited relationships do not exist, and transactions prohibited by firm policy have not occurred.
- 2. Assign responsibility for resolving exceptions to a person or group with appropriate authority.
- 3. Assign responsibility for obtaining representations and reviewing independence compliance files for completeness to a person or group with appropriate authority.
- 4. Review periodically accounts receivable from clients to ascertain whether any outstanding amounts take on some of the characteristics of loans and may, therefore, impair the firm's independence.

Assigning Personnel to Engagements

- 12. Policies and procedures for assigning personnel to engagements should be established to provide the firm with reasonable assurance that work will be performed by persons having the degree of technical training and proficiency required in the circumstances. In making assignments, the nature and extent of supervision to be provided should be taken into account. Generally, the more able and experienced the personnel assigned to a particular engagement, the less is the need for direct supervision.

Policies and Procedures

- 13. A firm should give consideration to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.
 - a. Delineate the firm's approach to assigning personnel, including the planning of overall firm and office needs and the measures employed to achieve a balance of engagement manpower requirements, personnel skills, individual development, and utilization.
 - 1. Plan the personnel needs of the firm on an overall basis and for individual practice offices.
 - 2. Identify on a timely basis the staffing requirements of specific engagements.

3. Prepare time budgets for engagements to determine manpower requirements and to schedule fieldwork.
 4. Consider the following factors in achieving a balance of engagement manpower requirements, personnel skills, individual development, and utilization:
 - (i) Engagement size and complexity
 - (ii) Personnel availability
 - (iii) Special expertise required
 - (iv) Timing of the work to be performed
 - (v) Continuity and periodic rotation of personnel
 - (vi) Opportunities for on-the-job training
- b. Designate an appropriate person or persons to be responsible for assigning personnel to engagements.
1. Consider the following in making assignments of individuals:
 - (i) Staffing and timing requirements of the specific engagement
 - (ii) Evaluations of the qualifications of personnel regarding experience, position, background, and special expertise
 - (iii) The planned supervision and involvement by supervisory personnel
 - (iv) Projected time availability of individuals assigned
 - (v) Situations where possible independence problems and conflicts of interest may exist, such as assignment of personnel to engagements for clients who are former employers or are employers of certain kin
 2. Give appropriate consideration, in assigning personnel, to both continuity and rotation to provide for efficient conduct of the engagement and the perspective of other personnel with different experience and backgrounds.

- c. Provide for approval of the scheduling and staffing of the engagement by the person with final responsibility for the engagement.
 1. Submit, where necessary, for review and approval the names and qualifications of personnel to be assigned to an engagement.
 2. Consider the experience and training of the engagement personnel in relation to the complexity or other requirements of the engagement and the extent of supervision to be provided.

Consultation

14. Policies and procedures for consultation should be established to provide the firm with reasonable assurance that personnel will seek assistance, to the extent required, from persons having appropriate levels of knowledge, competence, judgment, and authority. The nature of arrangements for consultation will depend on a number of factors, including the size of the firm and the levels of knowledge, competence, and judgment possessed by the persons performing the work.

Policies and Procedures

15. A firm should give consideration to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.
 - a. Identify areas and specialized situations where consultation is required, and encourage personnel to consult with or use authoritative sources on other complex or unusual matters.
 1. Inform personnel of the firm's consultation policies and procedures.
 2. Specify areas or specialized situations requiring consultation because of the nature or complexity of the subject matter. Examples include—
 - (i) Application of newly issued technical pronouncements.
 - (ii) Industries with special accounting, auditing, or reporting requirements.

Quality Control Policies and Procedures for CPA Firms

- (iii) Emerging practice problems.
 - (iv) Choices among alternative generally accepted accounting principles when an accounting change is to be made.
 - (v) Filing requirements of regulatory agencies.
3. Maintain or provide access to adequate reference libraries and other authoritative sources.
- (i) Establish responsibility for maintaining a reference library in each practice office.
 - (ii) Maintain technical manuals and issue technical pronouncements, including those relating to particular industries and other specialties.
 - (iii) Maintain consultation arrangements with other firms and individuals where necessary to supplement firm resources.
 - (iv) Refer problems to a division or group in the AICPA or state CPA society established to deal with technical inquiries.
4. Maintain a research function to assist personnel with practice problems.
- b. Designate individuals as specialists to serve as authoritative sources, and define their authority in consultative situations. Provide procedures for resolving differences of opinion between engagement personnel and specialists.
- 1. Designate individuals as specialists for filings with the Securities and Exchange Commission and other regulatory agencies.
 - 2. Designate specialists for particular industries.
 - 3. Advise personnel of the degree of authority to be accorded specialists' opinions and of the procedures to be followed for resolving differences of opinion with specialists.
 - 4. Require documentation of the considerations involved in the resolution of differences of opinion.

- c. Specify the extent of documentation to be provided for the results of consultation in those areas and specialized situations where consultation is required. Specify documentation, as appropriate, for other consultations.
 1. Advise personnel about the extent of documentation to be prepared and the responsibility for its preparation.
 2. Indicate where consultation documentation is to be maintained.
 3. Maintain subject files containing the results of consultations for reference and research purposes.

Supervision

16. Policies and procedures for the conduct and supervision of work at all organizational levels should be established to provide the firm with reasonable assurance that the work performed meets the firm's standards of quality. The extent of supervision and review appropriate in a given instance depends on many factors, including the complexity of the subject matter, the qualifications of the persons performing the work, and the extent of consultation available and used. The responsibility of a firm for establishing procedures for supervision is distinct from the responsibility of individuals to adequately plan and supervise the work on a particular engagement.

Policies and Procedures

17. A firm should give consideration to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.
 - a. Provide procedures for planning engagements.
 1. Assign responsibility for planning an engagement. Involve appropriate personnel assigned to the engagement in the planning process.
 2. Develop background information or review information obtained from prior engagements and update for changed circumstances.

3. Describe matters to be included in the engagement planning process, such as the following:
 - (i) Development of proposed work programs
 - (ii) Determination of manpower requirements and need for specialized knowledge
 - (iii) Development of estimates of time required to complete the engagement
 - (iv) Consideration of current economic conditions affecting the client or its industry and their potential impacts on the conduct of the engagement
- b. Provide procedures for maintaining the firm's standards of quality for the work performed.
 1. Provide adequate supervision at all organizational levels, considering the training, ability, and experience of the personnel assigned.
 2. Develop guidelines for the form and content of working papers.
 3. Utilize standardized forms, checklists, and questionnaires to the extent appropriate to assist in the performance of engagements.
 4. Provide procedures for resolving differences of professional judgment among members of an engagement team.
- c. Provide procedures for reviewing engagement working papers and reports.
 1. Develop guidelines for review of working papers and for documentation of the review process.
 - (i) Require that reviewers have appropriate competence and responsibility.
 - (ii) Determine that work performed is complete and conforms to professional standards and firm policy.

- (iii) Describe documentation evidencing review of working papers and the reviewer's findings. Documentation may include initialing working papers, completing a reviewer's questionnaire, preparing a reviewer's memorandum, and employing standard forms or checklists.
2. Develop guidelines for review of the report to be issued for an engagement. Considerations in (c), above, would be applicable to this review. In addition, the following matters should be considered for these guidelines:
- (i) Determine that the evidence of work performed and conclusions contained in the working papers support the report
 - (ii) Determine that the report conforms to professional standards and firm policy
 - (iii) Provide for review of the report by an appropriate individual having no other responsibility for the engagement

Hiring

18. Policies and procedures for hiring should be established to provide the firm with reasonable assurance that those employed possess the appropriate characteristics to enable them to perform competently. The quality of a firm's work ultimately depends on the integrity, competence, and motivation of personnel who perform and supervise the work. Thus, a firm's recruiting programs are factors in maintaining such quality.

Policies and Procedures

19. A firm should give consideration to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.
- a. Maintain a program designed to obtain qualified personnel by planning for personnel needs, establishing hiring objectives, and setting qualifications for those involved in the hiring function.

1. Plan for the firm's personnel needs at all levels and establish quantified hiring objectives based on current clientele, anticipated growth, personnel turnover, individual advancement, and retirement.
 2. Design a program to achieve hiring objectives which provides for—
 - (i) Identification of sources of potential hirees.
 - (ii) Methods of contact with potential hirees.
 - (iii) Methods of specific identification of potential hirees.
 - (iv) Methods of attracting potential hirees and informing them about the firm.
 - (v) Methods of evaluating and selecting potential hirees for extension of employment offers.
 3. Inform those persons involved in hiring about the firm's personnel needs and hiring objectives.
 4. Assign to authorized persons the responsibility for employment decisions.
 5. Monitor the effectiveness of the recruiting program.
 - (i) Evaluate the recruiting program periodically to determine whether policies and procedures for obtaining qualified personnel are being observed.
 - (ii) Review hiring results periodically to determine whether goals and personnel needs are being achieved.
- b. Establish qualifications and guidelines for evaluating potential hirees at each professional level.
1. Identify the attributes to be sought in hirees, such as intelligence, integrity, honesty, motivation, and aptitude for the profession.
 2. Identify achievements and experiences desirable for entry-level and experienced personnel; for example—
 - (i) Academic background.
 - (ii) Personal achievements.

- (iii) Work experience.
- (iv) Personal interests.
- 3. Set guidelines to be followed when hiring individuals in atypical situations, such as—
 - (i) Hiring relatives of personnel or relatives of clients.
 - (ii) Rehiring former employees.
 - (iii) Hiring client employees.
- 4. Obtain background information and documentation of qualifications of applicants by appropriate means, such as—
 - (i) Resumes.
 - (ii) Application forms.
 - (iii) Interviews.
 - (iv) College transcripts.
 - (v) Personal references.
 - (vi) Former employment references.
- 5. Evaluate the qualifications of new personnel, including those obtained from other than the usual hiring channels (for example, those joining the firm at supervisory levels or through merger or acquisition) to determine that they meet the firm's requirements and standards.
- c. Inform applicants and new personnel of the firm's policies and procedures relevant to them.
 - 1. Use a brochure or another means to so inform applicants and new personnel.
 - 2. Prepare and maintain a manual describing policies and procedures for distribution to personnel.
 - 3. Conduct an orientation program for new personnel.

Professional Development

20. Policies and procedures for professional development should be established to provide the firm with reasonable assurance that personnel will have the knowledge required to enable them to fulfill responsibilities assigned. Continuing professional education and training activities enable a firm to provide personnel with the knowledge required to fulfill responsibilities assigned to them and to progress within the firm.

Policies and Procedures

21. A firm should give consideration to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.
 - a. Establish guidelines and requirements for the firm's professional development program and communicate them to personnel.
 1. Assign responsibility for the professional development function to a person or group with appropriate authority.
 2. Provide that programs developed by the firm be reviewed by qualified individuals. Programs should contain statements of objectives and education and/or experience prerequisites.
 3. Provide an orientation program relating to the firm and the profession for newly employed personnel.
 - (i) Prepare publications and programs designed to inform newly employed personnel of their professional responsibilities and opportunities.
 - (ii) Designate responsibility for conducting orientation conferences to explain professional responsibilities and firm policies.
 - (iii) Enable newly employed personnel with limited experience to attend the AICPA or other comparable level staff training programs.
 4. Establish continuing professional education requirements for personnel at each level within the firm.

- (i) Consider state mandatory requirements or voluntary guidelines in establishing firm requirements.
 - (ii) Encourage participation in external continuing professional education programs, including college level and self-study courses.
 - (iii) Encourage membership in professional organizations. Consider having the firm pay or contribute toward membership dues and expenses.
 - (iv) Encourage personnel to serve on professional committees, prepare articles, and participate in other professional activities.
5. Monitor continuing professional education programs and maintain appropriate records, on both a firm and an individual basis.
- (i) Review periodically the records of participation by personnel to determine compliance with firm requirements.
 - (ii) Review periodically evaluation reports and other records prepared for continuing education programs to evaluate whether the programs are being presented effectively and are accomplishing firm objectives. Consider the need for new programs and for revision or elimination of ineffective programs.
- b. Make available to personnel information about current developments in professional technical standards and materials containing the firm's technical policies and procedures, and encourage personnel to engage in self-development activities.
1. Provide personnel with professional literature relating to current developments in professional technical standards.
- (i) Distribute to personnel material of general interest, such as pronouncements of the Financial Accounting Standards Board and the AICPA Auditing Standards Board.

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- (ii) Distribute pronouncements in areas of specific interest, such as those issued by the Securities and Exchange Commission, Internal Revenue Service, and other regulatory agencies to persons who have responsibility in such areas.
 - (iii) Distribute manuals containing firm policies and procedures on technical matters to personnel. Manuals should be updated for new developments and changing conditions.
2. For training programs presented by the firm, develop or obtain course materials and select and train instructors.
- (i) State the program objectives and education and/or experience prerequisites in the training programs.
 - (ii) Provide that program instructors be qualified in both program content and teaching methods.
 - (iii) Have participants evaluate program content and instructors of training sessions.
 - (iv) Have instructors evaluate program content and participants in training sessions.
 - (v) Update programs as needed in light of new developments, changing conditions, and evaluation reports.
- c. Provide, to the extent necessary, programs to fill the firm's needs for personnel with expertise in specialized areas and industries.
- 1. Conduct firm programs to develop and maintain expertise in specialized areas and industries, such as regulated industries, computer auditing, and statistical sampling methods.
 - 2. Encourage attendance at external education programs, meetings, and conferences to acquire technical or industry expertise.
 - 3. Encourage membership and participation in organizations concerned with specialized areas and industries.

4. Provide technical literature relating to specialized areas and industries.
- d. Provide for on-the-job training during the performance of engagements.
1. Emphasize the importance of on-the-job training as a significant part of an individual's development.
 - (i) Discuss with assistants the relationship of the work they are performing to the engagement as a whole.
 - (ii) Involve assistants in as many portions of the engagement as practicable.
 2. Emphasize the significance of personnel management skills and include coverage of these subjects in firm training programs.
 3. Encourage personnel to train and develop subordinates.
 4. Monitor assignments to determine that personnel—
 - (i) Fulfill, where applicable, the experience requirements of the state board of accountancy.
 - (ii) Gain experience in various areas of engagements and varied industries.
 - (iii) Work under different supervisory personnel.

Advancement

22. Policies and procedures for advancing personnel should be established to provide the firm with reasonable assurance that those selected for advancement will have the qualifications necessary for fulfillment of the responsibilities they will be called on to assume. Practices in advancing personnel have important implications for the quality of a firm's work. Qualifications that personnel selected for advancement should possess include, but are not limited to, character, intelligence, judgment, and motivation.

Policies and Procedures

23. A firm should give consideration to establishing policies to accomplish the objectives numbered below to the extent such

objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

- a. Establish qualifications deemed necessary for the various levels of responsibility within the firm.
 1. Prepare guidelines describing responsibilities at each level and expected performance and qualifications necessary for advancement to each level, including—
 - (i) Titles and related responsibilities.
 - (ii) The amount of experience (which may be expressed as a time period) generally required for advancement to the succeeding level.
 2. Identify criteria that will be considered in evaluating individual performance and expected proficiency, such as the following:
 - (i) Technical knowledge
 - (ii) Analytical and judgmental abilities
 - (iii) Communicative skills
 - (iv) Leadership and training skills
 - (v) Client relations
 - (vi) Personal attitude and professional bearing (character, intelligence, judgment, and motivation)
 - (vii) Possession of a CPA certificate for advancement to a supervisory position
 3. Use a personnel manual or other means to communicate advancement policies and procedures to personnel.
- b. Evaluate performance of personnel, and periodically advise personnel of their progress. Maintain personnel files containing documentation relating to the evaluation process.
 1. Gather and evaluate information on performance of personnel.

- (i) Identify evaluation responsibilities and requirements at each level indicating who will prepare evaluations and when they will be prepared.
 - (ii) Instruct personnel on the objectives of personnel evaluation.
 - (iii) Utilize forms, which may be standardized, for evaluating performance of personnel.
 - (iv) Review evaluations with the individual being evaluated.
 - (v) Require that evaluations be reviewed by the evaluator's superior.
 - (vi) Review evaluations to determine that individuals worked for and were evaluated by different persons.
 - (vii) Determine that evaluations are completed on a timely basis.
2. Periodically counsel personnel regarding their progress and career opportunities.
- (i) Review periodically with personnel the evaluation of their performance, including an assessment of their progress with the firm.

Considerations should include the following:
 - (a) Performance
 - (b) Future objectives of the firm and the individual
 - (c) Assignment preferences
 - (d) Career opportunities
 - (ii) Evaluate partners periodically by means of counseling, peer evaluation, or self appraisal, as appropriate, regarding whether they continue to have the qualifications to fulfill their responsibilities.
 - (iii) Review periodically the system of personnel evaluation and counseling to ascertain that—

- (a) Procedures for evaluation and documentation are being followed on a timely basis.
 - (b) Requirements established for advancement are being achieved.
 - (c) Personnel decisions are consistent with evaluations.
 - (d) Recognition is given to outstanding performance.
- c. Assign responsibility for making advancement decisions.
1. Assign responsibility to designated persons for making advancement and termination decisions, conducting evaluation interviews with persons considered for advancement, documenting the results of the interviews, and maintaining appropriate records.
 2. Evaluate data obtained giving appropriate recognition in advancement decisions to the quality of the work performed.
 3. Study the firm's advancement experience periodically to ascertain whether individuals meeting stated criteria are assigned increased degrees of responsibility.

Acceptance and Continuance of Clients

24. Policies and procedures should be established for deciding whether to accept or continue a client in order to minimize the likelihood of association with a client whose management lacks integrity. Suggesting that there should be procedures for this purpose does not imply that a firm vouches for the integrity or reliability of a client, nor does it imply that a firm has a duty to anyone but itself with respect to the acceptance, rejection, or retention of clients. However, prudence suggests that a firm be selective in determining its professional relationships.

Policies and Procedures

25. A firm should give consideration to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

- a. Establish procedures for evaluation of prospective clients and for their approval as clients.
 1. Consider evaluation procedures such as the following before accepting a client:
 - (i) Obtain and review available financial information regarding the prospective client, such as annual reports, interim financial statements, registration statements, Forms 10-K, other reports to regulatory agencies, and income tax returns.
 - (ii) Inquire of third parties about any information regarding the prospective client and its management and principals that may have a bearing on evaluating the prospective client. Inquiries may be directed to the prospective client's bankers, legal counsel, investment banker, underwriter, and others in the financial or business community who may have such knowledge. Credit reports may also be useful.
 - (iii) Communicate with the predecessor auditor as required by auditing standards. Inquiries should include questions regarding facts that might bear on the integrity of management, on disagreements with management regarding accounting principles, auditing procedures, or other similarly significant matters, and on the predecessor's understanding of the reasons for the change of auditors.
 - (iv) Consider circumstances that would cause the firm to regard the engagement as one requiring special attention or presenting unusual risks.
 - (v) Evaluate the firm's independence and ability to service the prospective client. In evaluating the firm's ability, consider needs for technical skills, knowledge of the industry, and personnel.
 - (vi) Determine that acceptance of the client would not violate applicable regulatory agency requirements and the codes of professional ethics of the AICPA or a state CPA society.

2. Designate an individual or group, at appropriate management levels, to evaluate the information obtained regarding the prospective client and to make the acceptance decision.
 - (i) Consider types of engagements that the firm would not accept or that would be accepted only under certain conditions.
 - (ii) Provide for documentation of the conclusion reached.
 3. Inform appropriate personnel of the firm's policies and procedures for accepting clients.
 4. Designate responsibility for administering and monitoring compliance with the firm's policies and procedures for acceptance of clients.
- b. Evaluate clients at the end of specific periods or upon the occurrence of specified events to determine whether the relationships should be continued.
1. Specify conditions that require evaluation of a client to determine whether the relationship should be continued. Conditions could include—
 - (i) Expiration of a time period.
 - (ii) Significant change since the last evaluation, including a major change in one or more of the following:
 - (a) Management
 - (b) Directors
 - (c) Ownership
 - (d) Legal counsel
 - (e) Financial condition
 - (f) Litigation status
 - (g) Nature of the client's business
 - (h) Scope of the engagement

- (iii) The existence of conditions that would have caused the firm to reject a client had such conditions existed at the time of the initial acceptance.
2. Designate an individual or group, at appropriate management levels, to evaluate the information obtained and to make continuance decisions.
 - (i) Consider types of engagements that the firm would not continue or that would be continued only under certain conditions.
 - (ii) Provide for documentation of the conclusion reached.
 3. Inform appropriate personnel of the firm's policies and procedures for continuing clients.
 4. Designate responsibility for administering and monitoring compliance with the firm's policies and procedures for continuance of clients.

Inspection

26. Policies and procedures for inspection should be established to provide the firm with reasonable assurance that the procedures relating to the other elements of quality control are being effectively applied. Procedures for inspection may be developed and performed by individuals acting on behalf of the firm's management. The type of inspection procedures used will depend on the controls established by the firm and the assignment of responsibilities within the firm to implement its quality control policies and procedures.

Policies and Procedures

27. A firm should give consideration to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.
 - a. Define the scope and content of the firm's inspection program.

1. Determine the inspection procedures necessary to provide reasonable assurance that the firm's other quality control policies and procedures are operating effectively.
 - (i) Determine objectives and prepare instructions and review programs for use in conducting inspection activities.
 - (ii) Provide guidelines for the extent of work at practice units, functions, or departments, and criteria for selection of engagements for review.
 - (iii) Establish the frequency and timing of inspection activities.
 - (iv) Establish procedures to resolve disagreements that may arise between reviewers and engagement or management personnel.
 2. Establish qualifications for personnel to participate in inspection activities and the method of their selection.
 - (i) Determine criteria for selecting reviewers, including levels of responsibility in the firm and requirements for specialized knowledge.
 - (ii) Assign responsibility for selecting inspection personnel.
 3. Conduct inspection activities at practice units, functions, or departments.
 - (i) Review and test compliance with applicable quality control policies and procedures.
 - (ii) Review selected engagements for compliance with professional standards, including generally accepted auditing standards, generally accepted accounting principles, and with the firm's quality control policies and procedures.
- b. Provide for reporting inspection findings to the appropriate management levels and for monitoring actions taken or planned.
1. Discuss inspection review findings on engagements reviewed with engagement management personnel.

2. Discuss inspection findings of practice units, functions, or departments reviewed with appropriate management personnel.
3. Report inspection findings and recommendations to firm management together with corrective actions taken or planned.
4. Determine that planned corrective actions were taken.

Quality Control Standards Committee (1979—1980)

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Note: This guide was issued by the AICPA Quality Control Committee to provide guidance for the application of Statement on Quality Control Standards 1. It does not have the authority of a pronouncement by the AICPA Quality Control Standards Committee. However, members of the AICPA and member firms of the division for CPA firms should be aware that they may be called upon to justify departures from the guide.



November 1993

To the Managing Partners of Private Companies
Practice Section Member Firms

Update No. 4 to the PCPS Reference Manual

Enclosed are the updates to the *Private Companies Practice Section Reference Manual*. Separate filing instructions are enclosed.

The following is a description of the major changes reflected in these materials:

- The peer review standards were revised to reflect the requirement that at least one audit of a federally insured depository institution with more than \$500 million in total assets be included in the scope of the review if the review is intended to satisfy the requirements of Section 36 to the Federal Deposit Insurance Act. In addition, a footnote was added to clarify that the reports on internal control and compliance with laws and regulations issued on such engagements should be reviewed if the audit engagement is selected for review.
- A footnote was added to the "Administrative Procedures of the Peer Review Committee" section stating that, if the peer review is intended to satisfy the requirements of Section 36 to the Federal Deposit Insurance Act, the peer review working papers should be retained for 120 days after the date the reviewed firm files the peer review documents with the Federal Deposit Insurance Corporation.
- The peer review standards were revised to add an appendix describing the Peer Review Committee's recent interpretation of peer review risk and its impact on the overall strategy for planning the scope of a peer review.
- The "Guidelines for a Report Review" (Guidelines) were revised to more closely align the performing and reporting requirements

with those of the off-site quality review standards as provided in QRP Section 3000, "Standards for Performing and Reporting on Quality Reviews" (Standards), contained in the AICPA Quality Review Program Manual. In addition, the Guidelines have been revised to reflect amendments to the standards proposed in a recent Exposure Draft prepared by the AICPA Quality Review Executive Committee in August 1993. The revisions become effective with report reviews conducted on or after April 1, 1994, unless the reviewed firm elects early adoption.

Major revisions are—

- Associations of CPA firms shall be permitted to arrange and carry out report reviews.
- The requirement to select sufficient engagements to achieve 5-10% of the reviewed firm's accounting hours has been eliminated.
- The reviewer shall select the type of engagements to be submitted for review that were issued by the reviewed firm during the review period.
- The reviewer shall report on the results of engagements submitted for review and not on the firm's accounting practice.
- The peer review standards were revised to allow the Peer Review Committee to have input on the materials submitted by a member firm to the AICPA Professional Ethics Division when the Committee requires the member firm to refer a matter to the Professional Ethics Division because the firm disagrees with the Committee on the resolution of a technical matter.
- The "Guidelines for and Illustrations of the Letter of Comments" was revised to add two new illustrative findings and an appendix on determining whether a finding also appeared in the report and letter of comments issued in connection with the firm's prior review.
- Footnote one to the "Interpretations of the Quality Control Standards" was revised to conform with the Peer Review Committee's recently changed guidelines on when to modify a peer review report for failure to perform an adequate inspection.

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November 1993
Page 3

- The "Administrative Procedures of the Peer Review Committee" section was revised to allow for the retention of administrative documents related to the scheduling of a peer review until the next review or until the time for such review has elapsed.

Please write to us if you have any questions about this update.

Sincerely,

A handwritten signature in cursive script that reads "Karen H. Jones".

Karen H. Jones, CPA
Senior Technical Manager
Quality Review Division

Enclosures

**Instructions for Filing Update No. 4 to the
Private Companies Practice Section Reference Manual**

The following materials in the loose-leaf manual should be removed and replaced in accordance with the filing instructions below.

Private Companies Practice Section Reference Manual	<u>Pages to Remove</u>	<u>Pages to Insert</u>
	Title page/ copyright page	Title page/ copyright page
<hr/>		
<i>Section II – Peer Review Program Standards</i>		
<i>Section 2000 – Standards for Performing and Reporting on Peer Reviews</i>	Title page/ Notice to Readers 2001 – 2050	Title page/ Notice to Readers 2001 – 2051
<i>Section 2200 – Writing Letters of Comments</i>	2201 – 2202 2227 – 2253	2201 – 2202 2227 – 2256
<i>Section 2300 – Writing Letters of Response</i>	2305 – 2308	2305 – 2308
<i>Section 2600 – Guidelines for a Report Review</i>	2601 - 2618	2601 - 2625
<hr/>		
<i>Section V – Administration</i>		
<i>Section 5000 – Administrative Procedures</i>	5001 – 5020	5001 – 5021
<hr/>		
<i>Appendixes</i>		
<i>Appendix B – Interpretations of Quality Control Standards</i>	10,013 – 10,014	10,013 – 10,014
<hr/>		
<i>Last Update Letter</i>		<i>Update Letter No. 4</i>
<hr/>		



Division for CPA Firms

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December 1992

To the Managing Partners of Private Companies
Practice Section Member Firms

Update No. 3 to the PCPS Reference Manual

Enclosed are the updates to the *Private Companies Practice Section Reference Manual*. Separate filing instructions are enclosed.

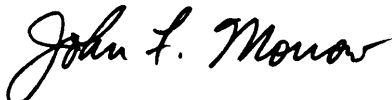
The following is a description of the major changes reflected in these materials:

- Effective April 1, 1994, the peer review standards require that a team captain must have completed at least eight hours of continuing professional education on performing peer and quality reviews within five years of the commencement of the review. Both the introductory AICPA reviewer training course titled "How to Conduct a Review Under the AICPA Practice Monitoring Programs," and the advanced AICPA reviewer training course titled "Current Issues in Practice Monitoring" fulfill this requirement.
- The peer review standards were revised to require that modified or adverse peer review reports include a reference to the letter of comments.
- An appendix was added to the "Administrative Procedures of the Peer Review Committee" defining the reviewer's responsibilities when performing a review, and the types of corrective or monitoring actions that may be imposed on reviewers as a result of deficient performance on peer reviews.
- The "Guidelines for Involvement by Associations of CPA Firms" were revised to indicate that associations of CPA firms arranging and carrying out reviews have a responsibility to establish policies and procedures for ensuring that reviews are carried out in a manner consistent with the PCPS peer review standards.

- The billing rate for reviewers appointed by the AICPA to perform report reviews has been changed to a fixed fee of \$250 for the first engagement reviewed, and \$150 for each additional engagement reviewed.
- The organizational document of the *PCPS Reference Manual* has been revised by the PCP executive committee to incorporate changes in certain administrative procedures.
- The PCP executive committee amended the "Continuing Professional Education Requirements" to conform with the *Statement on Standards of Formal Continuing Professional Education (CPE) Programs* of the AICPA, concerning programs qualifying for CPE credit.

Please write to us if you have any questions about this update.

Sincerely,



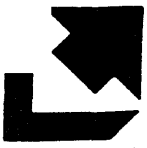
John F. Morrow, CPA
Director
Peer Review Programs

Enclosures

**Instructions for Filing Update No. 3 to the
Private Companies Practice Section Reference Manual**

The following materials in the loose-leaf manual should be removed and replaced in accordance with the filing instructions below.

Private Companies Practice Section Reference Manual	<u>Pages to Remove</u>	<u>Pages to Insert</u>
	Title page/ copyright page	Title page/ copyright page
	Table of Contents	Table of Contents
<hr/>		
Section I - Private Companies Practice Section (PCPS)		
<i>Section 1000 - Organizational Structure and Functions</i>	1001 - 1019	1001 - 1020
<hr/>		
Section II - Peer Review Program Standards		
<i>Section 2000 - Standards for Performing and Reporting on Peer Reviews</i>	2003 - 2004	2003 - 2004
	2009 - 2010	2009 - 2010
	2023 - 2026	2023 - 2026
	2037 - 2038	2037 - 2038
<i>Section 2100 - Peer Review Reports</i>	2103 - 2108	2103 - 2108
	2119 - 2128	2119 - 2128
<i>Section 2500 - Reviews of Continuing Professional Education Programs</i>	2503 - 2504	2503 - 2504
<i>Section 2600 - Report Reviews</i>	2609 - 2614	2609 - 2614
	2617 - 2618	2617 - 2618
<hr/>		
Section III - Associations		
<i>Section 3000 - Guidelines for Association Involvement</i>	3001 - 3007	3001 - 3007
<hr/>		
Section V - Administration		
<i>Section 5000 - Administrative Procedures</i>	5001 - 5004	5001 - 5004
	5017 - 5018	5017 - 5020
<hr/>		
Section VI - Continuing Professional Education		
<i>Section 6000 - Membership Requirements</i>	6001 - 6019	6001 - 6014
<hr/>		
Last Update Letter		Update Letter No. 3
<hr/>		



Division for CPA Firms

American Institute of Certified Public Accountants

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April 1992

To the Managing Partners of Private Companies
Practice Section Member Firms

Update No. 2 to the PCPS Reference Manual

Enclosed are the updates to the Private Companies Practice Section Reference Manual. Separate filing instructions are enclosed.

The following is a description of the major changes reflected in these materials:

- o The peer review standards were revised to require that a team captain attend the firm-wide exit conference and interact with the reviewed firm and review team during the conduct of the review.
- o The "Guidelines for Report Review of a Firm's Accounting Practice" section was expanded to include a discussion of the qualifications necessary to perform a report review.
- o A new "Guidelines for and Illustrations of the Letter of Comments" section was developed by the PCPS and SECPS Peer Review Committees and the AICPA Quality Review Executive Committee to further assist reviewers in preparing an effective letter of comments.
- o The peer review working paper retention policies were revised to require that all working papers, reports, and letters prepared during a PCPS peer review be retained until ninety days after the PCPS peer review committee has issued a letter accepting the peer review report, and, if applicable, the letter of comments and response thereto, unless the committee indicates that the working papers should be retained for a longer period of time.

Please write to us if you have any questions about this update.

Sincerely,

John F. Morrow, CPA
Director
Peer Review Programs

Enclosures

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**Instructions for Filing Update No. 2 to the
Private Companies Practice Section Reference Manual
(Loose-leaf Edition)**

The following materials in the loose-leaf manual should be removed and replaced with the contents of this package, according to the following filing instructions:

PCPS Section 1000
Organizational Structure
and Functions of the
Private Companies Practice
Section of the AICPA Division
for CPA Firms

- o Remove pages 1003 and 1004 and replace with the enclosed pages 1003 and 1004.

PCPS Section 2000
Standards for Performing
and Reporting on Peer
Reviews

- o Remove pages 2007 through 2038 and replace with the enclosed pages 2007 through 2038.

PCPS Section 2200
Writing Letters of
Comments

- o Remove pages 2201 through 2214 and replace with the enclosed pages 2201 through 2253.

PCPS Section 2600
Guidelines for a Report
Review of a Firm's
Accounting Practice

- o Remove pages 2601 through 2618 and replace with the enclosed pages 2601 through 2618.

PCPS Section 5000
Administrative Procedures

- o Remove pages 5001 through 5018 and replace with the enclosed pages 5001 through 5018.

Last Update Letter

- o Insert enclosed tab "Last Update Letter" after page 10,042.

- o Insert enclosed Update 2 Cover Letter and these instructions.