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## Activities of the Private Companies Practice Section



April 1985 Vol. 6 No. 2

# Reporter

Published by and for the Members of the Private Companies Practice Section of the AICPA Division for CPA Firms

Editor: John R. Mitchell

### REA Proposes Peer Review Requirement— Division Cheers

A proposed revision of the Rural Electrification Administration's policies concerning audits of REA borrowers would require "any CPA who audits an REA borrower . . . to belong to an approved peer review program." The proposal identifies the Division's program as acceptable, and indicates that an independent peer review program would generally be approved if it is structured according to the Division's published standards.

In a letter signed by John T. Schiffman and John W. Zick, the PCPS and SECPS chairmen, the Division strongly endorsed the proposal. Noting that member firms "are participating in a program designed to provide objective evidence to the firm, to its clients, to users of financial statements, and to the public in general of its conformity with professional standards in the conduct of its accounting and audit practice," Messrs. Schiffman and Zick affirmed that "those who engage CPA firms to perform accounting and audit services and those who rely on financial statements audited by CPAs have a right to request objective evidence of that quality."

A number of state and local government units have either required reviews or given preference to reviewed firms. However, as far as this *Reporter* can determine, this is the first time a federal agency has proposed a peer review requirement.

Other federal agencies that require audits have recognized peer review. For example, a recent request for proposal from the Department of Agriculture's Inspector General provides for up to five (of a total of 100) technical evaluation points for "extent of peer review participation (i.e. AICPA or State Board of Accounting)." The RFP was for up to 5,000 accountant/auditor hours, renewable for another 1,000 to 5,000.

The REA's proposal, published in the January 23 *Federal Register*, states under a "background" caption:

Increasing reliance on the work of CPAs auditing REA borrowers requires that REA be assured that quality audits are being performed. One of the most significant recent developments in the public accounting profession has been the emergence of independent peer reviews of a firm's quality control procedures and workpapers by other CPAs or other CPA firms. A peer review program provides a mechanism for evaluating the quality of audit work performed by CPAs auditing REA borrowers. CPAs may join a peer review program through the AICPA, state accounting societies or other associations of public accountants.

Currently, 104 of the 538 CPAs auditing REA borrowers participate in the AICPA peer review program. REA is proposing to require peer reviews of all CPAs auditing REA borrowers after December 31, 1985. These peer reviews will be performed by accounting practitioners working in the private sector rather than by government employees. A favorable peer review report will provide reasonable assurance to REA that the independent CPA selected by the borrower has adhered to generally accepted accounting principles and auditing standards. Only in unusual circumstances will it be necessary for an REA employee to review the quality of a CPA's work.

Early in March the Section mailed the REA proposal to each member firm. A number wrote to the REA supporting the peer review requirement. The proposal notes that public comment must be received no later than March 25.

The REA's proposal also included a number of requirements related to audit procedures, documentation and reporting. As it frequently does for such proposals, the Institute's Federal Government Division submitted technical comments and suggestions. Its comment letter does not address the peer review proposal. □

### Slide Show Yours for the Asking

As part of its public information program, the Division has furnished its local and regional spokespersons with a slide show explaining the Division's origin and objectives, and emphasizing the benefits of membership requirements such as peer review. The show takes about nine minutes and can be used either to introduce a longer presentation about the Division or as a module in a presentation on some related topic.

A few sets are available for loan from the Section. Each set consists of a carousel slide tray with 66 slides, an accompanying audiotape, the latter's script, and instructions for use.

It was designed to be a very flexible package. For instance, the audiotape, which takes about nine minutes, is cued to advance the projector, leaving the presenter completely free. Of course, this requires the right type of projector and tape player, equipment that can be easily rented in most cities.

Alternatively, any tape cassette player can be used, while the presenter advances the slides manually by following along on the script. Another approach is to show the slides while the presenter delivers the audio portion himself, using the typed script as a guide.

To borrow the slide show, write or call Ms. William Colon at the Section's offices, (212) 575-6447. □

## Review Report Inquiries Soar

While the Division does not keep records of the requests it receives for peer review reports and other information in members' public files, the personnel processing these requests report a recent staggering increase in their workload. They attribute this largely to recent press coverage of the profession in general and the Division in particular.

Here are a few samples, with identities disguised.

A March 1 letter from a Houston subsidiary of a bank holding company.

Dear Sir/Madam:

As a commercial bank officer dealing with middle market companies, I often come across audited statements prepared by CPAs or CPA firms which I know nothing about. The Peer Reviews prepared by you would be a valuable resource in determining the quality of the audited statements which I examine. If it would be possible to send copies of the most recent reviews for each Houston area firm, I would be greatly appreciative.

I am impressed that these reviews exist and am sure they will better enable me to analyze my customers' and prospects' statements.

Sincerely,  
John A. Doe  
Commercial Banking Officer

A March 8 letter from a midwestern state board of accountancy.

Gentlemen:

I understand from a recent news article that certain items are available upon request regarding the Division for CPA Firms. Please forward a copy of the latest listing of the *Directory of Member Firms*. I also request that I be provided with a copy of the most recent peer review reports issued on firms in this state which are members of the Division.

Thank you for your attention to this request.

Sincerely,  
John B. Doe  
Executive Director

A March 12 letter from a regional headquarters of a major bank's commercial banking division.

Dear Ms. Langebartels:

I have received the *Directory of Member Firms*, 9/1/84. If possible, I would like to request a report on the member firms' peer review for the firms checked off on the attached lists.

Thank you.

Sincerely,  
John C. Doe  
Commercial Banking Officer  
(About half the firms on the three enclosed directory pages were checked. Almost all were local firms.)

## Membership Profile

Measured by the number of member firms, PCPS membership declined 7% in the past year. By every other measure, membership increased. The number of professionals in member firms is up 3.7%, and the number of CPAs 1.3%.

This continues the trend of the last few years.

Member firms seem to be getting bigger and stronger, but the Section is still losing members among firms with from one to five professionals. You can help by spreading the word to these firms about some of our recent initiatives, such as consulting reviews, off-site limited reviews of firms with no audit clients, and the member consultation service.

## PCPS Membership Statistics

	<u>March 1985</u>	<u>March 1984</u>	<u>March 1983</u>
<b>TOTALS</b>			
Number of Member Firms	1,572	1,691	1,701
Number of CPAs in Member Firms	58,586	57,838	56,593
Number of Professionals in Member Firms	104,068	100,356	99,844
<b>RATIOS</b>			
Number of Partners			
1	13.8%	14.2%	14.9%
2-5	59.8	61.0	60.1
6-10	18.8	17.8	18.4
11 or more	7.6	7.0	6.6
	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>
Number of Professionals			
1	5.3%	5.4%	5.7%
2-5	17.2	19.6	20.0
6-10	24.3	24.0	23.7
11-20	27.2	26.9	26.2
21-50	19.8	18.3	18.7
51 or more	6.2	5.8	5.7
	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>
Number of Offices			
1	69.8%	70.6%	71.1%
2-5	27.0	26.7	26.0
6 or more	3.2	2.7	2.9
	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>
Number of SEC Clients			
None	81.7%	81.5%	82.0%
1-4	15.0	15.6	15.4
5 or more	3.3	2.9	2.6
	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

### Quality Review Scorecard

Past articles have identified the deficiencies found most frequently in various types of practice reviews. Readers report that this helps them avoid similar problems. It also contributes directly to the PCPS's first formal objective—to "improve the quality of services by CPA firms to private companies. . . ."

The article that follows may be helpful to member firms that serve municipalities as well as private companies. It is a condensed version of a report by PCPS member Gregory B. Arnott of the Minnesota Society of CPAs' City Quality Review Subcommittee, which is part of the Society's Governmental Accounting and Auditing Committee. The report appeared originally in the February 1985 *Footnote*, a newsletter published by the Minnesota Society.

In an effort to improve the quality of financial reporting for municipalities in Minnesota, the Governmental Accounting and Auditing Committee annually reviews selected municipal annual financial reports. Areas for improvement are noted and communicated to the individuals or firms who opined on the financial statements.

Subcommittee members reviewed 52 audit reports for the year ended December 31, 1983. The audits were performed by:

	Population	
	Over 2500	Under 2500
Certified Public Accountants	25	18
Public Accountants	—	7
Office of the State Auditor	1	—
Other	1	—
<b>Total</b>	<b>27</b>	<b>25</b>

The checklist used for the review addresses the financial statements, footnotes, and opinion sections of the annual financial reports. A comparison of this year's results to the prior indicated no improvements to the financial statement and footnote sections for cities over 2,500, while the opinion section showed a significant increase in the number of opinions that did not disclose deficiencies in footnote disclosures and opinions issued that did not seem appropriate in the circumstances.

Only the opinion section is completed for cities under 2,500. Auditors noted noticeable improvements in: inclusion of required financial statements; proper basis of accounting; proper references in the opinions to combining, individual fund, and statistical information included in the report.

Many opinions were qualified because the municipalities did not maintain historical cost records of general fixed assets. The wording of the qualifica-

tion in substantially all the qualified opinions was incorrect because the qualification should indicate it pertains to the possible effects on the financial statements and not to the scope limitation itself (refer to AU 509.34 and .40 for further clarification).

As with the review of school districts, many city annual financial reports did not include numerous disclosures in the footnotes that are required for fair presentation of the financial statements.

In discussing audits of governmental units with sole practitioners and small firm representatives, it is apparent that many audits are being performed without having available for reference the Statements and Interpretations promulgated by the National Council on Governmental Accounting, Statements issued by the Governmental Accounting Standards Board, and the industry audit guide entitled *Audits of State and Local Governmental Units*, as amended by certain Statements of Position.

In addition to the prior announcements that have been incorporated as a part of "generally accepted accounting principles" by the Governmental Accounting Standards Board, auditors should consider obtaining applicable publications of the Government Finance Officers Association (Suite 800, 180 North Michigan Avenue, Chicago, IL 60601) as part of their reference materials.

Auditors performing or considering governmental auditing services must be prepared to obtain and maintain current knowledge in this specialized area. Continuing education courses are one means to gain the requisite background but cannot alone be relied upon to provide all the information necessary to serve governmental units. □

### More from the Mailbag

One of the few differences between PCPS and SECPS peer review standards is that reviewers' comment letters, and the firms' responses, are public information only in the SECPS. We are therefore not identifying the source of the response letter from which the following is excerpted.

We wish to comment upon the excellence, competence, and professional attitude that were so characteristic of our two peer reviewers, Don Donohoo and Don Clayton. They were very informative and handled their responsibilities in a very tactful and courteous manner. They are a credit to our PCPS Division. Our Firm gained much more than can be described in this letter.

Donovan L. Donohoo is a partner in D. L. Donohoo & Co., Batavia, OH. Donald H. Clayton is a partner in Schmaltz & Company, P.C., Southfield, MI. □

### Helping Out—Visibly—at Small Business Conferences

Last year Congress authorized the President to conduct a National White House Conference on Small Business, not later than September 1, 1986. The statute provides that the national conference “shall be preceded by state and regional conferences with at least one such conference being held in each state.”

The stated purpose includes a number of objectives towards which practicing CPAs can make important contributions, such as identifying the problems of small business and developing recommendations for executive and legislative action to enhance the economic viability of small businesses. CPAs, with their broad familiarity with businesses in their communities, are uniquely qualified to play important roles at the state and regional conferences. Since most participants are expected to be small business owners, the resulting visibility could be valuable.

The statute provides that representatives of small business concerns—which most CPA firms are—are entitled to admission to the preliminary conferences, and

that admission fees must be reasonable. It is not yet clear how to apply for admission, or to volunteer to help with the planning and preparations (and thus, maybe, seize a prominent leadership role). Developments may come quickly, and it would probably make sense for interested CPAs to stay in touch with local business groups and nearby offices of the U.S. Small Business Administration to make sure they are among the first to learn how to become involved. □

### MAP Conference Schedule Set

This year the AICPA's Management of an Accounting Practice Committee has scheduled two three-day conferences. The first is July 17-19, in Denver; and the second September 11-13, in New Orleans. Each conference will address more than a dozen practice management topics.

This is the twelfth year that the MAP Committee has presented its always-popular practice management conferences. Each conference offers 24 hours of CPE credit, and the registration fee is \$360.

For more information, call David McThomas, (212) 575-6439. □

## PCPS Reporter

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