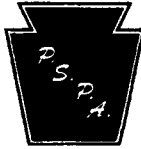


Original: 2056  
Mizner



# Pennsylvania Society of Public Accountants

Executive Office • 900 North Second Street • Harrisburg, PA 17102  
1(800) 270-3352 • (717) 234-4129 • FAX (717) 234-9556

Sandusky  
Smith  
Wilmarth  
Legal

Mr. Robert E. Nyce  
Executive Director  
Independent Regulatory Review Commission  
14<sup>th</sup> Floor, Harristown 2  
333 Market Street  
Harrisburg, PA 17101

March 9, 1999

FORTHCOMING  
Nyce  
Sandusky  
Gelnett

INDEPENDENT REGULATORY  
REVIEW COMMISSION

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Dear Mr. Nyce:

I am writing to inform you of a situation that is currently taking place within the Pennsylvania State Board of Accountancy. As you are aware, a new accounting law (Act 140) was passed in December of 1996. Since that time we have been waiting for the Board's draft of regulations particularly on the issue of peer review. While the Board has discussed their proposal, and has in fact held a public comment period, they have not yet submitted anything for publication in the Pennsylvania Bulletin, nor have they presented their proposal to IRRC or to the legislative committees.

Recently the Board has published their Winter 1998-99 newsletter, and included is a disturbing article regarding peer review and the effective dates, which appear to be in direct conflict with the actual statutory language of Act 140. It seems that the Board has bypassed IRRC and the legislative committees, and is trying to enforce their own interpretation of the law.

Enclosed is a copy of the series of letters that have been sent to the House and Senate Committees, as well as a copy of the newsletter article. I am submitting these to you simply for informational purposes, as I realize you are not yet in receipt of these regulations. Please contact me if you have any questions, or if you need additional information. Thank you for your time.

Sincerely,

Sherry L. DeAgostino  
Executive Director

## FROM THE OFFICE OF THE

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- PRESIDENT ELECT • MARY LEW KEHM, CPA  
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# Peer Review Reminder!

Licenses are reminded that Section 8.9 of the CPA Law, which was added by Act 140 of 1996, requires firms and sole practitioners who perform audit and review engagements to complete a peer review of their accounting and auditing practices as condition of maintaining current licensure.

The important deadlines are as follows:

- **Non-exempt firms and sole practitioners who perform audit engagements after May 1, 1998 shall complete an on-site peer review before the biennial license period that begins May 1, 2000.**

- **Non-exempt firms and sole practitioners who perform review engagements, but not audit engagements, after May 1, 1998 shall complete an off-site peer review before the biennial license period that begins May 1, 2004.**

Section 8.9 exempts from peer review firms and sole practitioners who do not perform audits or review engagements or who have completed timely peer reviews in other states with peer review requirements equal to Pennsylvania's. Section 8.9 also permits the board to grant exemptions from peer review, for periods of up to 12 months, for reasons of health, military service or other good cause.

Generally, non-exempt firms of three or more members will not be required to complete a peer review more frequently than once every three years; non-exempt firms of one or two members and sole practitioners will not be required to complete a peer review more frequently than once every five years. The board has the discretion to lengthen the period between peer reviews.

The board is currently developing regulations that implement the peer review requirements of Section 8.9. To obtain copies of Section 8.9 and the board's draft peer review regulations, please contact the board's administrative office at P.O. Box 2649, Harrisburg, PA 17105-2649; (717) 783-1404.

FORTHCOMING

Nyce \_\_\_\_\_  
Sandusky \_\_\_\_\_  
Gelnett \_\_\_\_\_

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PENNSYLVANIA

State Board of  
**Accountancy**

P.O. Box 2649  
Harrisburg, PA 17105-2649

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Permit No. 918  
Harrisburg, PA

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INDEPENDENT STATE BOARD OF ACCOUNTANCY  
PEER REVIEW COMMISSION



# Pennsylvania Society of Public Accountants

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INDEPENDENT REGULATORY  
REVIEW COMMISSION

COPY

February 3, 1999

Ms. Barbara Harr  
c/o House Box 202020  
Harrisburg, PA 17120-2020

FORTHCOMING  
Nyce \_\_\_\_\_  
Sandusky \_\_\_\_\_  
Gelnett \_\_\_\_\_

Dear Ms. Harr:

This letter comes as a follow up to our meeting held this past November. As you may recall, at that time we briefly discussed regulations that were then being drafted by the Pennsylvania State Board of Accountancy as a result of the passage of Act 140 - the CPA Law.

Of particular concern were the effective dates for mandatory peer review for audit and review engagements, and the conflict which exists between Act 140 and the Board's proposed regulations, of which you were already aware. Although the proposed regulations have not yet been completed, we've been informed that they will be published in the *Pennsylvania Bulletin* prior to the Board's next scheduled meeting on April 25, 1999.

The majority of licensees are unaware of the content of the State Board's regulatory proposal. The only language that licensees have been presented with appears in Act 140. Act 140 clearly states that the requirement for mandatory peer review for audit engagements would not become effective until the biennial period ending 2002, and for review engagements until the biennial renewal period ending 2004.

Licensees have made, and are continuing to make practice decisions based on the statute. The State Board's proposal places an undue burden on licensees. It is unfair and impractical to bombard licensees with a requirement that conflicts with state law, and one that would give licensees less than six months with which to comply.

In addition to the effective dates mentioned above, there are other issues that appear to be taking on new meaning in the Board's regulatory proposal. One issue of particular concern involves the Board's proposed language regarding commissions. The Board is attempting to add more restrictive regulatory language than appears in Act 140. We are aware of the tremendous amount of time and effort put forth by your committee to pass what we consider a fair and equitable piece of legislation - Act 140. However, we fear that these efforts are being threatened by the State Board of Accountancy's proposed regulations.

We have made our position known to the State Board of Accountancy and will be issuing our positions to IRRC at the appropriate time. I hope we can count on your continued support and the support of your committee regarding this matter. Please do not hesitate to contact me or our Executive Director if you have any questions regarding the position of the PSPA or if you need any further information.

Sincerely,

Neil C. Trama, PA  
PSPA President

## FROM THE OFFICE OF THE

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REVIEW COMMISSION  
**COPY**

Honorable Mario Civera  
House Box 202020  
Harrisburg, PA 17120-2020

FORTHCOMING  
Nyce \_\_\_\_\_  
Sandusky \_\_\_\_\_  
Gelnett \_\_\_\_\_

February 24, 1999

Dear Representative Civera:

Attached is a copy of an article that will appear in the State Board of Accountancy's Winter 1998-99 newsletter. The newsletter will soon be distributed to all accounting licensees within the Commonwealth. The language that appears in this article conflicts with that which appears in Act 140, the CPA Statute. (Please refer to the enclosed letter to you dated February 3, 1999.)

While Act 140 states that licensees would not be required to undergo a peer review "until May 1, 2000," the article claims that licensees "shall complete an on-site peer review before the biennial license period that begins May 1, 2000." In addition, it is evident that they are once again reverting back to the absurd "6 year lookback" for review engagements accepted after May 1, 1998.

It is unclear to me how or why the Accountancy Board has the authority to print this article regarding regulatory language that hasn't even been referred to the Independent Regulatory Review Commission or to either of the legislative committees. Does the State Board of Accountancy have the authority to make policy or circumvent the Pennsylvania Legislature and the regulatory review process as they have done? This article will most likely result in sheer panic by licensees who were completely unaware that Act 140 could ever be interpreted in this way, giving them less than ten months to comply.

I would greatly appreciate your comments regarding this issue. Thank you for your time.

Sincerely,

Neil C. Trama, Jr., PA  
President, PSPA

cc. House Professional Licensure Committee

## FROM THE OFFICE OF THE

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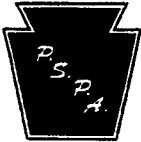
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February 24, 1999 99 MAR 16 AM 9:52

Senator Clarence Bell  
ATTN: Alexandra Matthews  
C/o Senate Post Office  
Main Capitol Building  
Harrisburg, PA 17120

FORTHCOMING  
Nyce \_\_\_\_\_  
Sandusky \_\_\_\_\_  
Gelnett \_\_\_\_\_

INDEPENDENT REGULATORY  
REVIEW COMMISSION  
**COPY**

Dear Ms. Matthews:

Attached is a copy of an article that will appear in the State Board of Accountancy's Winter 1998-99 newsletter. The newsletter will soon be distributed to all accounting licensees within the Commonwealth. The language that appears in this article conflicts with that which appears in Act 140, the CPA Statute. (Please refer to the enclosed letter to you dated February 3, 1999.)

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It is unclear to me how or why the Accountancy Board has the authority to print this article regarding regulatory language that hasn't even been referred to the Independent Regulatory Review Commission or to either of the legislative committees. Does the State Board of Accountancy have the authority to make policy or circumvent the Pennsylvania Legislature and the regulatory review process as they have done? This article will most likely result in sheer panic by licensees who were completely unaware that Act 140 could ever be interpreted in this way, giving them less than ten months to comply.

I would greatly appreciate your comments regarding this issue. Thank you for your time.

Sincerely,

Neil C. Trama, Jr., PA  
President, PSPA

cc. Senate Consumer Protection & Professional Licensure Committee

## FROM THE OFFICE OF THE

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Original: 2056

Mizner

**Lawrence D. Kessler**  
**Certified Public Accountant**  
512 West Third Street  
Lansdale, Pennsylvania 19446

cc: Sandusky  
Smith  
Wilmarth  
Legal

(215) 362-9101  
fax (215) 362-5538

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REVIEW COMMISSION

FORTHCOMING

Nyce \_\_\_\_\_  
Sandusky \_\_\_\_\_  
Gelnett \_\_\_\_\_

Honorable Robert W. Godshall  
1702 Cowpath Road  
Hatfield, PA 19440

Dear Honorable Robert W. Godshall:

I am writing in opposition to recent actions that have been taken by the Pennsylvania State Board of Accountancy. The Board's Winter 1998-99 newsletter contains an article that conflicts with Act 140 -the CPA Law.

While Act 140 states that licensees would not be required to undergo a peer review "until May 1, 2000", the article claims that licensees "shall complete an on-site peer review before the biennial license period that begins May 1, 2000". In addition, the Board is requiring an off-site peer review before the biennial license period that begins May 1, 2004 for review engagements performed after May 1, 1998. In essence the Board will be requiring a peer review in 2004 on work that was performed six years prior.

Although the article states that it is a "reminder", I have received no information from the State Board of Accountancy up until this point regarding peer review, and according to this article, I have only several months to comply with the May, 2000 deadline. The only document that I have received is Act 140, with which there is a clear conflict. No regulations have been submitted to the Independent Regulatory Review Commission.

I urge you to oppose the State Board's attempt to bypass the legislative process! Please uphold the original language that was passed by the legislature in Act 140. That is, on-site peer review would not be required for audit engagements until May 1, 2000 for the license renewal in 2002; and off-site peer review would not be required for review engagements until May 1, 2004 for the license renewal in 2006.

Thank you for your support.

Sincerely,



Lawrence D. Kessler, CPA

(h) In any civil action, arbitration or administrative proceeding, regardless of whether a licensee is a party thereto, all of the following shall apply:

(1) ~~The proceedings, records (including, without limitation, letters of acceptance, peer review reports, letters of comment and letters of response) and working papers related to the peer review process of any reviewer, administering organization or board member are privileged and not subject to discovery, subpoena or other means of legal process and may not be introduced into evidence.~~

(2) ~~No employe, member or agent of an administering organization, reviewer or board member shall be permitted or required to testify as to any matters produced, presented, disclosed or discussed during or in connection with the peer review process or be required to testify to any finding, recommendation, evaluation, opinion or other actions of any person in connection with the peer review process.~~

(3) No privilege exists under this subsection:

(i) For information presented or considered in the peer review process that was otherwise available to the public.

(ii) For material not prepared in connection with a peer review merely because they subsequently are presented or considered as part of the peer review process.

(iii) In connection with an administrative proceeding or related civil action brought for the purpose of enforcing this section.

(i) If a peer review report indicates that a firm complies with the appropriate professional standards and practices set forth in the regulations of the board, the administering organization shall destroy all working papers and documents, other than report-related documents, related to the peer review within ninety days after issuance to the firm of the letter of acceptance by the administering organization. If a peer review letter of acceptance indicates that corrective action by a firm is required, the administering organization may retain documents and reports related to the peer review until completion of the next peer review or other agreed-to corrective actions.

(j) In the event the practices of two or more firms are merged or otherwise combined, the surviving firm shall retain the peer review year of the largest firm, as determined by the number of accounting and auditing hours of each of the practices. In the event that the practice of a firm is divided or a portion of its practice is sold or otherwise transferred, any firm acquiring some or all of the practice that does not already have its own review year shall retain the review year of the former firm. In the event that the first peer review of a firm that would otherwise be required by this subsection would be less than twelve months after its previous review, a review year shall be assigned by the administering organization so that the firm's next peer review occurs after not less than twelve months of operation, but not later than eighteen months of operation.

(k) (1) None of the following persons shall be held to have violated any criminal law or to be civilly liable by reason of the performance by him or it of any duty, function or activity under this section so long as the person has not engaged in recklessness or willful misconduct:

(i) reviewers;

(ii) the administering organization or any of its members, employees or agents or any person furnishing professional counsel or services to the administering organization; or

(iii) board members.

(2) Subsection (h) shall not apply to the defense of a claim alleging conduct not protected under clause (1).

(l) This section shall apply as follows:

(1) Except as provided in clause (2), this section shall take effect on (The Legislative Reference Bureau shall insert here the effective date of this amendatory act). This clause includes without limitation effectiveness for the purposes of permitting the board to promulgate the regulations under subsection (c) and of applying subsections (h) and (k).

(2) This section shall not become applicable to firms and no firm shall be required to undergo a peer review under this section, until May 1, 2000; except that this section shall not

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### Section 9. Disc Appeals<sup>18</sup>

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- (6) Pleading crime, an eleme district, territor Federal or State

(6.1) Pleading violating any F

become applicable until May 1, 2004, to a firm that has not accepted or performed any audit engagements during the period May 1, 1998, through April 30, 2004.

Section 11. Sections 9, 9.1, 9.2 and 9.3 of the act, amended March 7, 1984 (P.L. 106, No. 23), are amended to read:

**Section 9. Disciplinary Procedure for the Suspension and Revocation of Certificates; Appeals**<sup>18</sup>

The (a) Except as provided in section 2.3(c) of this act, the procedure to be followed in the suspension and revocation of certificates, registrations or licenses to practice under this act, ~~censure of certificate holders or registrants, revocation of a firm's license under section 8.8(g) of this act or the imposition of discipline under section 9.1 of this act, and in appeals taken from disciplinary actions of the board shall be that prescribed by the act, approved the fourth day of June, one thousand nine hundred forty-five (Pamphlet Laws 1988), known as the Administrative Agency Law, and its amendments, and any General Rules of Administrative Practice and Procedure under 2 Pa.C.S. Ch. 5 Subch. A (relating to practice and procedure of Commonwealth agencies) and Ch. 7 Subch. A (relating to judicial review of Commonwealth agency action), 1 Pa. Code Part II (relating to general rules of administrative practice and procedure) and applicable regulations promulgated by the board pursuant to said act.~~

(b) The board shall require an individual whose certification has been suspended or revoked to return his certificate or to certify in such manner as the board directs that it was lost, stolen or destroyed. Failure to comply with the board's directions shall be a misdemeanor of the third degree.

**Section 9.1. Revocation or Suspension of Certificate, Registration or License**

**Grounds for Discipline.**—<sup>19</sup>(a) In accordance with the procedure referred to provided in section 9 of this act, the board, by a majority vote of its maximum authorized membership as provided by law, or by a majority vote of the duly qualified and confirmed membership or a minimum of seven affirmative votes, whichever is greater, if the membership of the board is less than its authorized membership as provided by law, may revoke or suspend any, limit or otherwise restrict the certificate of a certified public accountant or the registration of those registered under this act, or a public accountant, may revoke, suspend or refuse to renew, limit or otherwise restrict any license issued under of this act, or may censure or publicly reprimand the holder of any such certificate, registration or license, may require completion of general or a specific number of continuing professional education courses or may require more frequent peer review or other remedial action for any one or any combination of the following causes:

(1) Fraud or deceit in obtaining a certificate as of certified public accountant or in obtaining registration under this act or in obtaining a license to practice under this act.

(2) Dishonesty, fraud or gross negligence in the practice of public accounting.

(3) Violation of any of the provisions of section 12 of this act.

(4) Violation of a rule of professional conduct promulgated by the board under the authority granted by this act.

(5) Pleading guilty to, entering a plea of nolo contendere, to or being found guilty of a felony under the laws of any state or Federal district, territory or insular possession of the United States or of the United States, any Federal or State law or the laws of any foreign jurisdiction.

(6) Pleading guilty to, entering a plea of nolo contendere, to or being found guilty of any crime, an element of which is dishonesty or fraud under the laws of any state or Federal district, territory or insular possession of the United States or of the United States, any Federal or State law or the laws of any foreign jurisdiction.

(6.1) Pleading guilty to, entering a plea of nolo contendere to or being found guilty of violating any Federal or State revenue law or the revenue laws of any foreign jurisdiction.

<sup>18</sup> 63 P.S. § 9.9.

<sup>19</sup> 63 P.S. § 9.9a.



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(6) The qualified nonlicensee has graduated with a baccalaureate or higher degree from a college or university approved at the time of graduation by the Department of Education.

(7) The qualified nonlicensee shall comply with all applicable provisions of this act and the regulations of the board.

(f) An equity interest in a firm may be owned indirectly but only if all of the ultimate, indirect beneficial owners of the equity interest are licensees.

(g) In accordance with the procedure referred to in section 9 of this act, the board may revoke the license to practice of a firm if at any time it is in violation of any of the provisions of this section.

**Section 8.9. Peer Review.**—(a) As a condition for granting a firm a renewal license, or an initial license in the case of a firm that has previously been engaged in practice in another jurisdiction, the board shall require that the firm undergo a peer review in accordance with this section unless the firm meets one of the exemptions in subsection (g). The firm shall submit to the board with its license application a letter from the organization administering the firm's most recent peer review stating the date on which the peer review was completed. The board shall not require submittal of the letter of acceptance, peer review report, letter of comment, letter of response or working papers related to the peer review process. As used in this section, the term "firm" includes, but is not limited to, a sole practitioner.

(b) A firm with less than three licensees shall not be required to undergo a peer review more frequently than once every five years and a firm with three or more licensees shall not be required to undergo a peer review more frequently than once every three years, except that:

(1) The board may order a firm that has been disciplined under section 9.1 of this act or that has been ordered to take remedial action under subsection (e) to undergo a peer review more frequently.

(2) A new firm that is not subject to subsection (j) shall undergo its first peer review within eighteen months after it is granted its initial license.

(3) The regulations of the board may lengthen any of the periods between required peer reviews prescribed in this subsection in such manner, under such circumstances or with respect to such firms as the board in its discretion may consider appropriate.

(c) The board shall adopt regulations establishing guidelines for peer reviews which shall:

(1) Require that a peer review be conducted pursuant to a program and standards approved by the board. The board shall approve only peer review programs that the board finds comply with established standards for performing and reporting on peer reviews.

(2) Require that a peer review be conducted by a reviewer that is independent of the firm reviewed, qualified pursuant to board rules and approved by the organization administering the peer review program.

(3) *Other than in the peer review process, prohibit the use or public disclosure of information obtained by the reviewer, any organization administering an approved peer review program or the board during or in connection with the peer review process. The requirement that information not be publicly disclosed shall not apply to a hearing before the board that the firm requests be public under subsection (e) or to the information described in subsection (h)(3).*

(d) (1) *The peer review of a firm that performs one or more audits of historical financial statements or examinations of prospective financial information shall include an onsite study and evaluation of a representative selection of audit, examination, review and compilation reports, the financial information upon which those reports were based and the associated working papers. The onsite review shall include additional procedures relating to the firm's system of quality control sufficient to provide the reviewer with a reasonable basis upon which to issue a peer review report.*

(2) *The peer review of a firm that performs no audit or examination engagements but does perform one or more review engagements shall be required only to be an offsite study and evaluation of a representative selection of reports issued by the firm and the financial information upon which those reports were based; but, if such a firm elects to have an onsite review, that review shall also be acceptable. The offsite review shall not be required to include a study of the associated working papers but shall include procedures and inquiries sufficient to provide the reviewer with a reasonable basis upon which to issue a peer review report.*

(3) *A firm that does not perform any audits or reviews, regardless of whether or not the firm performs compilations, shall be exempt from the requirement to undergo a peer review to the extent provided in subsection (g)(2).*

(e) *If a firm does not comply with any remedial actions determined appropriate by the administering organization, the administering organization shall refer the matter to the board to determine if further action under this subsection is warranted. The board may at its discretion or shall upon submission of a written application by the firm hold a hearing to determine whether the firm complies with the appropriate professional standards and practices. The hearing shall be confidential and shall not be open to the public unless requested by the firm. If the board after conducting a hearing determines that the firm complies with the appropriate professional standards and practices, it shall issue an order requiring the reviewer and the administering organization to take any necessary action to record and implement the board's determination and to restore the status of compliance of the firm. However, if the board after conducting the hearing determines that the firm does not comply with the appropriate professional standards and practices, it may issue an order that requires both of the following:*

(1) *Remedial action which*  
 (i) *Requiring employment of continuing professional education*  
 (ii) *Requiring the firm to undergo a peer review every three years.*

(iii) *Any other remedial action*  
 (2) *An affidavit from the board indicating completion*

(f) *The firm reviewed shall be*  
 (g) *A firm shall be exempt from peer review if all of the following*

(1) *Within three years of the last renewal licensure, the firm is licensed in another state or foreign jurisdiction*  
 subsection (c)(1) and (2). *The organization administering the date on which the peer review*

(2) *The firm satisfies all of the following*  
 (i) *During the preceding year, the firm has performed any audit or review*

(ii) *Within the next two years, the firm will perform any audit or review*

(iii) *The firm agrees to no longer engage in an audit or review engagement for a period of eighteen months of commencement*

(3) *For reasons of personal convenience, the board determines that the period of time not to exceed one year*

(h) *In any civil action, the provisions of this subsection shall apply, regardless of whether a licensure action is pending.*

(1) *The proceedings, records, acceptance, peer review reports and working papers related to the administering organization or to discovery, subpoena or otherwise introduced into evidence.*

(2) *No employee, member, reviewer or board member shall be compelled to produce, present, or disclose any matters produced, presented, or disclosed in connection with the peer review process, recommendation, evaluation, or other action taken in connection with the peer review process.*

(3) *No privilege exists under this subsection.*

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However, if the board after  
rm does not comply with the  
es, it may issue an order that

- (1) Remedial action, which may include any or all of the following:
- (i) Requiring employes of the firm to complete general or specific continuing professional education courses.
  - (ii) Requiring the firm to undergo a peer review more frequently than every three years.
  - (iii) Any other remedial action specified by the board.
- (2) An affidavit from the firm submitted within the time specified by the board indicating completion of the required remedial actions.
- (f) The firm reviewed shall pay for any peer review performed.
- (g) A firm shall be exempt from the requirement to undergo a peer review if all of the following apply:
- (1) Within three years before the date of application for initial or renewal licensure, the firm has undergone a peer review conducted in another state or foreign jurisdiction which meets the requirements of subsection (c)(1) and (2). The firm shall submit to the board a letter from the organization administering the firm's most recent peer review stating the date on which the peer review was completed.
  - (2) The firm satisfies all of the following conditions:
    - (i) During the preceding two years, the firm has not accepted or performed any audit or review engagement.
    - (ii) Within the next two years, the firm does not intend to accept or perform any audit or review engagement.
    - (iii) The firm agrees to notify the board within thirty days of accepting an audit or review engagement and to undergo a peer review within eighteen months of commencing such activities.
  - (3) For reasons of personal health, military service or other good cause, the board determines that the firm is entitled to an exemption for a period of time not to exceed twelve months.
- (h) In any civil action, arbitration or administrative proceeding, regardless of whether a licensee is a party thereto, all of the following shall apply:
- (1) The proceedings, records (including, without limitation, letters of acceptance, peer review reports, letters of comment and letters of response) and working papers related to the peer review process of any reviewer, administering organization or board member are privileged and not subject to discovery, subpoena or other means of legal process and may not be introduced into evidence.
  - (2) No employe, member or agent of an administering organization, reviewer or board member shall be permitted or required to testify as to any matters produced, presented, disclosed or discussed during or in connection with the peer review process or be required to testify to any finding, recommendation, evaluation, opinion or other actions of any person in connection with the peer review process.
  - (3) No privilege exists under this subsection:

Original: 2056  
Mizner  
cc: Sandusky  
Smith  
Wilmarth  
Legal



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COMMONWEALTH OF PENNSYLVANIA  
DEPARTMENT OF STATE  
BUREAU OF PROFESSIONAL AND OCCUPATIONAL AFFAIRS  
P.O. BOX 2649  
HARRISBURG, PA 17105-2649

INDUSTRIAL SECURITY  
REVIEW COMMISSION

STATE BOARD OF ACCOUNTANCY

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April 13, 1999

The Honorable Mario J. Civera, Jr.  
Majority Chairman  
Professional Licensure Committee  
Pennsylvania House of Representatives  
315-D Main Capitol Building  
Harrisburg, PA 17120

FORTHCOMING  
Nyce  
Sandusky  
Gelnett

Handwritten initials 'N' and 'S' over horizontal lines, and a signature 'G' over horizontal lines.

Dear Representative Civera:

I am writing in response to your letter of March 23, 1999, in which you questioned the State Board of Accountancy's interpretation of the CPA Law regarding the deadlines for peer review compliance.

As you point out in your letter, the Board recently notified licensees in its newsletter that May 1, 2000, the start of the next biennial license period, is the deadline for peer review compliance for non-exempt licensees who perform audit engagements after May 1, 1998, while May 1, 2004, is the compliance deadline for non-exempt licensees who perform review engagements but not audit engagements after May 1, 1998. You state that these deadlines appear to conflict with Section 8.9(l)(2) of the CPA Law, which provides:

"This section [relating to peer review] shall not become applicable to firms and no firm shall be required to undergo a peer review under this section until May 1, 2000, except that this section shall not become applicable until May 1, 2004, to a firm that has not accepted or performed any audit engagements during the period May 1, 1998, through April 30, 2004."

The Board, however, is basing its interpretation on Section 8.8(c) of the CPA Law, which provides:

"An initial or renewal license shall not be issued to a firm after April 30, 2000, unless the firm complies with the requirements of Section 8.9 of this act [relating to peer review]."

As you know, Sections 8.9(l)(2) and 8.8(c) were added to the CPA Law as part of sweeping amendments set forth in House Bill 1172, which eventually passed as Act 140 of 1996. The Board had been advised by the Pennsylvania Institute of Certified Public Accountants,

April 13, 1999

Page 2

which drafted House Bill 1172, as well as by Representative Howard L. Fargo, the bill's prime sponsor, that the intent of the legislation was to require peer review compliance for non-exempt licensees performing audit engagements and those performing review engagements by May 1, 2000, and May 1, 2004, respectively. It was also the Board's understanding that information about these compliance deadlines had been widely disseminated by the PICPA prior to the notice that appeared in Board's newsletter. I have enclosed for your review copies of letters from Representative Fargo and Albert E. Trexler, the PICPA's executive director, on the subject of deadlines for peer review compliance.

The Board is aware of its need to promulgate regulations in connection with peer review. The Board has shared exposure drafts of its peer review regulations with the PICPA and the Pennsylvania Society of Public Accountants, soliciting their input. I have enclosed for your review a copy of the Board's final exposure draft. The Board intends to publish proposed regulations before the end of spring and to complete final rulemaking by the fall.

Because of the widespread publicity about the upcoming compliance deadlines for peer review, as well as the large number of licensees who currently participate in voluntary peer review programs, the Board believes that the majority of non-exempt licensees subject to the compliance deadline of May 1, 2000, either have already completed a peer review or have made arrangements to complete a timely peer review. For those non-exempt licensees who, for good cause, are unable to complete a peer review by the May 1, 2000, deadline, the Board is prepared to grant extensions of up to 12 months as authorized by Section 8.9(g)(3) of the CPA Law.

If you should desire more information about the peer review compliance deadlines or the peer review regulations generally, I would be happy to meet with you at your convenience.

Sincerely,



Thomas J. Baumgartner, CPA  
Chairman, State Board of Accountancy

TJB/SW  
Enclosures

cc: The Honorable Clarence D. Bell, Chairman  
Senate Consumer Protection and Professional Licensure Committee

The Honorable Howard L. Fargo, State Representative

The Honorable Kim Pizzigrilli, Secretary of the Commonwealth

David Williams, Special Assistant/Legislative Liaison  
Department of State

The Honorable Dorothy Childress, Commissioner  
Bureau of Professional and Occupational Affairs

Albert E. Trexler, Executive Director  
Pennsylvania Institute of Certified Public Accountants

HOWARD L. FARGO  
MAJORITY CAUCUS CHAIRMAN

RULES COMMITTEE

CHAIRMAN  
LEGISLATIVE AUDIT  
ADVISORY COMMISSION



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315 ELM STREET  
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1-800-287-0085

October 28, 1998

Kevin M. Mitchell, CPA  
Chairman  
Pennsylvania State Board of Accountancy  
P. O. Box 2649  
Harrisburg, PA 17105-2649

Dear Mr. Mitchell:

The new CPA statute, Act 140 of 1996, provides for the peer review of certified public accountants (CPAs) and public accountants (PAs) in Pennsylvania. I understand that the State Board is currently considering regulations on peer review. As the prime sponsor of this legislation, which originated as House Bill 1782, I would like to discuss the intent of that legislation in regard to the timing of peer reviews.

As background, please be aware that the initial version of H.B. 1782 (Printer's Number 2207) required all licensed firms that performed any attest function to have completed a peer review by May 1, 2000.

Due to concerns raised by small accounting firms, however, I proposed the following compromise based on the level of attest activities, which now appears in Act 140. First, because firms which limit their practice to performing compilations do not provide assurances on these compilation engagements, I recommended that they be exempt from the peer review requirements. Second, because firms which perform reviews provide limited assurance on such engagements, I recommended that they not be required to complete a peer review until May 1, 2004. Finally, those firms which perform audits, which is the highest level of attest activity, would still be required to undergo a peer review by the originally planned date of May 1, 2000.

Page 2

My compromise proposal, as I recall, was accepted and agreed to by the House Professional Licensure Committee on April 9, 1996. I support the proposed draft regulations which the State Board of Accountancy has sent to interested parties and request that the starting dates for peer review be retained when the Board publishes proposed regulations in the *Pennsylvania Bulletin*.

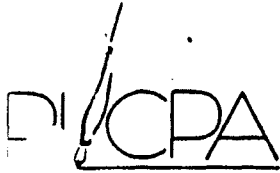
Thank you for considering my views on this subject of mutual interest. Should you have any further questions regarding interpretations of the CPA statute, Act 140 of 1996, please feel free to contact me.

Sincerely,



Howard L. Fargo, CPA  
State Representative  
8<sup>th</sup> Legislative District

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CERTIFIED PUBLIC ACCOUNTANTS

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February 25, 1998

Steven J. Wennberg, Esq.  
Pennsylvania State Board of Accountancy  
P. O. Box 2649  
Harrisburg, PA 17105-2649

Dear Mr. Wennberg:

Recently, a question has arisen regarding the effective date of the peer review requirement for those firms which perform audits. The Pennsylvania Institute of Certified Public Accountants (PICPA) has always maintained that peer reviews for firms or individual practitioners which perform audits must be completed on or before May 1, 2000. Furthermore, the peer review of firms or individual practitioners which perform reviews and no audits must be completed on or before May 1, 2004. The CPA Statute addresses the effective date of peer review in two sections.

Section 8.8 (c) states: "An initial or renewal license shall not be issued to a firm after April 30, 2000, unless the firm complies with the requirements of Section 8.9 of this act."

Section 8.9 (1)(2) states: "This section shall not become applicable to firms and no firm shall be required to undergo a peer review under this section until May 1, 2000, except that this section shall not become applicable until May 1, 2004, to a firm that has not accepted or performed any audit engagements during the period May 1, 1998, through April 30, 2004."

The Pennsylvania Rules of Statutory Construction state: "Every statute shall be construed, if possible, to give effect to all its provisions." 1 Pa.C.S.A. Section 1921(a). Furthermore, the Rules of Statutory Construction state that "the General Assembly intends the entire statute to be effective and certain." 1 Pa.C.S.A. Section 1922 (2). Finally, the Rules of Statutory Construction provide that "[s]tatutes or parts of statutes are in pari materia when they relate to the same persons or things or to the same class of persons or things." 1 Pa.C.S.A. Section 1932(a). "Statutes in pari materia shall be construed together, if possible, as one statute." 1 Pa.C.S.A. Section 1932(b).

Thus, Section 8.8 (c) and 8.9(1)(2) should be read together. Reading them together, it is clear that after April 30, 2000, no accounting license shall be issued

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to a firm or to a sole practitioner which performs audits if that firm or licensee has not undergone a peer review by May 1, 2000.

The new licensing period begins on May 1, 2000. These sections apply to firms and individual practitioners on May 1, 2000, and the requirement must be in place in order for the licensee or firm to receive its new license or renewal on May 1, 2000.

Section 8.9 (1)(2) provides in the second clause that those firms or individual practitioners which conduct only reviews and not audits are required to obtain a peer review by May 1, 2004. The last clause of that section clarifies that the time period for performing only reviews (and not audits) is from May 1, 1998 through April 30, 2004. Clearly, the use of the date May 1, 1998 again supports our position that the period to be considered is the licensing period beginning May 1, 1998 and ending on April 30, 2000 for those firms that conduct audits. Furthermore, those firms or licensees performing reviews but no audits during this time frame (from May 1, 1998 through April 30, 2004) must have completed a peer review on or before May 1, 2004.

If this were not the case, the statute would have never used the date of May 1, 1998. Rather, if one maintains that the peer review requirement does not begin until May 1, 2000 for those conducting audits, the legislature would have used the date of May 1, 2000 instead of May 1, 1998 in the last clause. The Rules of Statutory Construction clearly provide that "the General Assembly does not intend a result that is absurd, impossible of execution or unreasonable." 1 Pa.C.S.A. Section 1922(1). Thus, when all of these sections are considered together, the result is clear: firms or individual practitioners performing audits from May 1, 1998 through April 30, 2000 must have completed a peer review on or before May 1, 2000. Those firms or individual practitioners performing only reviews and no audits from May 1, 1998 through April 30, 2004 must have completed a peer review on or before May 1, 2004.

As stated in the first paragraph, the PICPA has continued to maintain its interpretation of peer review for several years. We have consistently conveyed this same position to the legislature, to the State Board of Accountancy, to our members and to the general public. When House Bill 1782 was passed by the Pennsylvania House of Representatives, we stated on page 2 of the July 1996 issue of *Legislative Alert* (copy enclosed):

The peer review requirement will apply as follows:

- Firms that perform audits will be required to have undergone a peer review on or before May 1, 2000.
- Firms that perform reviews, but do not perform audits, will be required to undergo a peer review on or before May 1, 2004.

When House Bill 1782 was passed by the legislature and signed by the governor, we reiterated our statement on page 1 in the January 1997 issue of *Legislative Alert* (copy enclosed). When the PICPA presented an explanation of the CPA statute to the State Board of Accountancy on January 29, 1997, we included this entire issue of *Legislative Alert* in our packet of materials and discussed these provisions with the Board at that time.

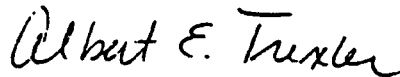
Once the CPA statute was enacted, the PICPA also published the following statement in the Spring 1997 issue of the *Pennsylvania CPA Journal* on page 23 (copy enclosed).

The peer review requirement will apply as follows:

- Firms and individual practitioners that perform audits will be required to have completed a peer review of their accounting and auditing practices prior to the licensing period beginning May 1, 2000.
- Firms and individual practitioners that perform reviews, but not audits, will be required to have completed a peer review of their practices prior to the licensing period beginning May 1, 2004.

Thank you for reviewing our concerns on this interpretation of the statute. When you have had an opportunity to review this letter, please give me a call at 1-888-272-2001.

Sincerely,



Albert E. Trexler, CAE  
Executive Director

Enclosures

ANNEX A

TITLE 49. PROFESSIONAL AND VOCATIONAL STANDARDS  
PART I. DEPARTMENT OF STATE  
SUBPART A. PROFESSIONAL AND OCCUPATIONAL AFFAIRS  
CHAPTER 11. STATE BOARD OF ACCOUNTANCY

\* \* \*

PEER REVIEW

§11.81. Definitions.

The following words and terms, when used in §§11.82-11.88 (relating to peer review), shall have the following meanings.

Administering organization - An entity that has met, and at all relevant times continues to meet, the standards specified by the Board for administering the peer review program.

Firm - A licensee who is a sole practitioner or a licensee that is a qualified association as defined in section 2 of the act (63 P.S. §9.2).

Peer review - A study, appraisal or review of one or more aspects of the professional work of an individual or firm in the practice of public accounting to determine the degree of compliance by the individual or firm with generally accepted accounting principles and auditing standards and other generally accepted technical standards, conducted by persons who hold current licenses to practice public accounting under the laws of this Commonwealth or another state and who are not affiliated with the individual or firm being reviewed.

Peer reviewer or reviewers - An individual or individuals directly engaged in the conducting of on-site or off-site peer reviews.

Team captain - A peer reviewer with primary responsibility for the following:

- (i) Planning, organizing and conducting the review.
- (ii) Supervising the work of other peer reviewers during the review.
- (iii) Communicating the findings to the reviewed firm and to the administering organization.
- (iv) Preparing the peer review report.
- (v) Preparing other related documents (if necessary).

**§11.82. Compliance with peer review requirement; effective dates.**

(a) A firm that is subject to peer review under section 8.9 of the act (relating to peer review) shall take all steps necessary to complete peer review when scheduled and to submit a letter of completion with its application for initial licensure or license renewal. A firm's failure to receive any notices required by the act or this chapter shall not excuse a firm from its obligation to comply with these requirements.

(b) A non-exempt firm that performs an audit engagement after May 1, 1998 shall complete a peer review before the license biennium that begins May 1, 2000.

(c) A non-exempt firm that performs a review engagement, but not an audit engagement, after May 1, 1998 shall complete a peer review before the license biennium that begins May 1, 2004.

**§11.83. Administering organizations for peer review.**

The following organizations are deemed qualified to administer peer review programs:

(1) The Security and Exchange Commission Practice Section and the Private Companies Practice Section of the AICPA.

(2) Any state society or institute that fully participates in the AICPA Peer Review Program.

**§11.84. Peer review standards.**

A peer review shall conform to the "Standards for Performing and Reporting in Peer Reviews," including interpretations thereof, promulgated by the AICPA. This section shall not require any firm or licensee to become a member of the AICPA or any administering organization.

**§11.85. Qualifications of peer reviewers.**

A peer reviewer shall possess the following qualifications:

(1) Be currently licensed to practice as a certified public accountant or public accountant with a firm that has received an unqualified report on its system of quality control or its off-site peer review within the past three years.

(2) Possess current knowledge of applicable professional standards, including knowledge of current rules and regulations applicable to the industries for which engagements are reviewed. Such knowledge may be obtained from on-the-job training, training courses, or a combination of both. A reviewer of an engagement in a high-risk industry should possess not only current knowledge of professional standards but also current knowledge of the accounting practices specific to that industry. If a reviewer does not have such experience, the reviewer may be called upon to justify why the reviewer should be permitted to review engagements in that industry. The organization administering the peer review shall have the authority to decide whether a reviewer's experience is sufficient to perform a particular review.

(3) Have at least five years of recent experience in the practice of public accounting in the accounting or auditing function. For purposes of this paragraph,

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

(4) Be one of the following:

(i) Be currently active in public practice at a supervisory level in the accounting or auditing function of a firm enrolled in a peer review program, provided such individual is an owner or manager of the firm or possesses equivalent supervisory responsibilities.

(ii) Be a sole practitioner with a public accounting or auditing practice who is enrolled in a peer review program.

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

(5) Be competent to conduct a peer review in accordance with the standards set forth in §11.84 (relating to peer review standards) and have completed peer review training coursework that meets the requirements of the Board.

(6) Be independent from, and have no conflict of interest with, the firm or individual being reviewed.

**§11.86. Qualifications of team captains.**

A team captain shall possess the following qualifications:

(1) Be qualified as a peer reviewer under §11.85 (relating to qualifications of peer reviewer).

(2) Be an owner of a firm that has received an unqualified report on the system of quality control for its accounting and auditing practice for its most recently completed peer review. If the individual is associated with more than one firm, then each of the firms with which the individual is associated must have received an unqualified report on its most recently completed peer review of its accounting and auditing practice.

(3) Have a completed training coursework that meets the requirements of the Board.

**§11.87. Peer review of multi-state firms.**

(a) A multi-state firm may submit a peer review based solely on work conducted outside Pennsylvania if the following conditions are met:

(1) The peer review is completed by the deadline prescribed in the act and this chapter.

(2) The peer review is performed in accordance with standards equivalent to those prescribed in this chapter.

(3) The peer review.

(i) Studies, evaluates and reports on the quality control system of the firm as a whole, in the case of an on-site review.

(ii) Results in an evaluation and report on selected engagements, in the case of an off-site review.

(4) The firm's internal inspection or monitoring procedures require that the firm's personnel from an

office outside Pennsylvania perform an inspection of the firm's office in Pennsylvania at least once every three years.

(5) The report issued by the peer reviewer complies with the requirements of this act and this chapter.

(b) A multi-state firm that desires approval of an out-of-state peer review under subsection (a) shall submit an application to the administering organization by February 1 of the calendar year in which the peer review is scheduled to be performed. The application shall set forth information establishing that the proposed peer review complies with subsection (a).

(c) A multi-state firm shall submit its out-of-state peer review to the administering organization within 30 days of its acceptance.

(d) A multi-state firm that is denied approval of its out-of-state peer review by the administering organization shall undergo a peer review of its offices in Pennsylvania in compliance with requirements of the act and this chapter.

**§11.88. Confidentiality of peer review reports; exceptions.**

(a) All peer review reports and related information shall remain confidential except as provided in section 8.9(e) and (h)(3) of the act (63 P.S. §9.8i(e) and (h)(3)) and subsection (b) of this section.

(b) The Board shall have the right to inquire of an administering organization whether a peer review report has been accepted.





# Pennsylvania Society of Public Accountants

Executive Office • 900 North Second Street • Harrisburg, PA 17102  
1(800) 270-3352 • (717) 234-4129 • FAX (717) 234-9556  
www.pspa-state.org

September 14, 1999

Mr. Steven Wennberg, Esq.  
Counsel, State Board of Accountancy ORIGINAL: 2056  
P.O. Box 2649 MIZNER  
Harrisburg, PA 17105-2649 COPIES: Sandusky  
Smith  
Wilmarth  
Wyatte

Dear Mr. Wennberg:

The following comments are being submitted in response to the State Board of Accountancy's proposed peer review regulations, 49 Pa. Code, Section 11.81-11.86. The position of the Pennsylvania Society of Public Accountants is shared by many solo practitioners and small accounting firms within the Commonwealth, as can be seen by the attached letters. Please contact our Executive Office if any additional information is required.

## 11.82 Effective dates for peer review compliance: proof of compliance or exemption.

Section 8.9(l)(2) of Act 140 - the CPA Law, the operative section dealing with peer review provides as follows:

"This section shall not become applicable to firms and no firm shall be required to undergo a peer review under this section until May 1, 2000; except that this section shall not become applicable until May 1, 2004, to a firm that has not accepted or performed any audit engagements during the period May 1, 1998, through April 30, 2004." (Emphasis added.)

The foregoing provision is the single controlling section in the entire Act as to when a licensee is required to "undergo a peer review." The essential effect of this provision is that a firm which performs "audits" is not required "to undergo a peer review...until May 1, 2000..."

Further, if a firm "has not accepted or performed any audit engagements during the period May 1, 1998, through April 30, 2004," then this provision goes on to state that it "shall not become applicable until May 1, 2004..." Thus, the essential effect of this provision is that licensees who perform something other than an audit (i.e., a review engagement) are not "required to undergo a peer review...until May 1, 2004..."

## FROM THE OFFICE OF THE

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The effective dates that have been proposed by the State Board of Accountancy under Section 11.82(a) and (b), conflict with the above effective dates prescribed in Act 140. The State Board of Accountancy seeks to require the licensee to obtain a peer review **before** the license biennium that begins May 1, 2000, for audits accepted or performed after May 1, 1998; and require the licensee to obtain a peer review **before** the license biennium that begins May 1, 2004, for review engagements accepted or performed after May 1, 1998, thus completely changing the intended effect of the dates prescribed in Act 140.

This proposed change has far-reaching affects on the public accounting community:

1. First and foremost, many licensees are unaware of the State Board of Accountancy's proposal. It has been more than two years since the passage of Act 140. Licensees have made, and are continuing to make, practice decisions based on the written statute. The language that the State Board of Accountancy is now proposing conflicts with that statute.

The Professional Licensure Committee of both the House and Senate have received numerous letters of protest from licensees who became aware of the Board's proposed effective dates through a 5-sentence newsletter article that was circulated by the Board in March, 1999. The article caused alarming confusion within the public accounting profession, and prompted Chairman of the House Professional Licensure Committee, the Honorable Mario Civera, to submit a letter to the Board "respectfully demanding" that (the Board) retract the article, as it conflicted with the accounting law.

2. The State Board of Accountancy's proposal is a retroactive regulation. Licensees, unknowing of the Board's proposal, who accepted an audit or review engagement after May 1, 1998, would be forced to comply with a regulation that, when they accepted the engagement over a year ago, they knew nothing about.

3. The administration of the peer review program will be a large undertaking. The State Board of Accountancy does not currently have the necessary components in place to administer or monitor the program.

4. There is currently less than eight months available to comply with the proposed regulation. Most of the time remaining to comply would fall between the months of January and April, the busiest time of year for sole practitioners and smaller accounting firms, placing a significant burden on those firms.

**Section 11.83 Administering organizations for peer review; firm membership not required, and Section 11.84 Peer review standards.**

The Pennsylvania Society of Public Accountants, as well as many of the legislators involved with the passage of Act 140, made a concerted effort to eliminate references to private organizations and interest groups in the original statute. In particular, all references to the American Institute of Certified Public Accountants (AICPA) were stricken from the original version of HB 1782.

The references to AICPA, and the AICPA standards contained in the State Board of Accountancy's proposal, already pose a significant problem. Recently the AICPA has circulated an exposure draft (dated 5/17/99) on peer review that would require firms that perform review engagements to undergo a "systemic" (on-site) peer review, rather than an off-site review, as is currently prescribed in Act 140.

Because the Board is basing its regulations specifically on the AICPA "Standards for Performing and Reporting on Peer Review", this change, or any change to the AICPA program, will affect Pennsylvania's peer review requirement. The Pennsylvania State Board of Accountancy, recognizing the vulnerability of our state peer review requirement if AICPA goes through with this change, is in the process of drafting comments urging the AICPA not to change its program.

The Pennsylvania Society of Public Accountants opposes the direct references to the AICPA program in the State Board of Accountancy's proposal.

We thank you for the opportunity to submit our position regarding Section 11.81-11.86. Please contact our Executive Office at 1-800-270-3352 if additional information is needed.

Sincerely,



Mary Lew Kehm, CPA  
PSPA President

enclosures.

KRIEGSTEIN, KIM, WRIGHT & HAGENBUCHER, P.C.

CERTIFIED PUBLIC ACCOUNTANTS

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INDEPENDENT REGULATORY  
REVIEW COMMISSION

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March 18, 1999

SEP 1 1999

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Senator Clarence D. Bell, Chairman  
C/o Senate Post Office  
Senate of Pennsylvania  
Harrisburg, Pennsylvania 17120

I am writing in opposition to recent actions that have been taken by the Pennsylvania State Board of Accountancy. The Board's winter 1998-99 newsletter contains an article that conflicts with Act 140 the CPA law.

While Act 140 states that licenses would be required to undergo a peer review "until May 1, 2000" the article claims that licensees "shall complete an on-site peer review before the biennial license period that begins May 1, 2000." In addition, the Board is requiring an off-site peer review before the biennial license period that begins May 1, 2004 for review engagements performed after May 1, 1998. In essence the Board will be requiring a peer review in 2004 on work that was performed six years prior.

Although the article states that it is a "reminder", I have received no information from the State Board of Accountancy up until this point regarding peer review and according to this article I have only several months to comply with the May 1, 2000 deadline. The only documents I've received are Act 140, with which there is a clear conflict. No regulations have been submitted to the Independent Regulatory Review Commission.

I urge you to oppose the State Board's attempt to bypass the legislative process! Please uphold the original language that was passed by the legislature in Act 140. That is, on-site peer review would not be required for audit engagements until May 1, 2000 for the license renewal in 2002; and off-site peer review would not be required for review engagements until May 1, 2004 for the license renewal in 2006.

Thank you for your support.

Sincerely,

*Janis Rico Hagenbucher*

Janis Rico Hagenbucher, CPA

KRIEGSTEIN, KIM, WRIGHT & HAGENBUCHER

KRIEGSTEIN, KIM, WRIGHT & HAGENBUCHER, P.C.

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Haddon Heights, NJ 08035  
(609) 546-8400

March 18, 1999

Honorable Mario J. Civera Jr. Chairman  
c/o House Box 202020  
Harrisburg, Pennsylvania 17120-2020

I am writing in opposition to recent actions that have been taken by the Pennsylvania State Board of Accountancy. The Board's winter 1998-99 newsletter contains an article that conflicts with Act 140 the CPA law.

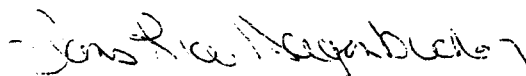
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I urge you to oppose the State Board's attempt to bypass the legislative process! Please uphold the original language that was passed by the legislature in Act 140. That is, on-site peer review would not be required for audit engagements until May 1, 2000 for the license renewal in 2002; and off-site peer review would not be required for review engagements until May 1, 2004 for the license renewal in 2006.

Thank you for your support.

Sincerely,



Janis Rico Hagenbucher, CPA  
KRIEGSTEIN, KIM, WRIGHT & HAGENBUCHER

*R.C. Guarrry & Associates, Inc.*

PUBLIC ACCOUNTING OFFICES

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RICHARD C. GUARRY, P.A.

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REVIEW COMMISSION  
SEP 15, 1999

P.O. BOX 55  
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PEN ARGYL, PA 18072  
(610) 863-5898  
FAX: (610) 863-8414

Senator Charlie Dent, Vice Chairman  
c/o Senate Post Office  
Senate of Pennsylvania  
Harrisburg, PA 17120

Dear Senator Dent:

I am writing in opposition to recent actions that have been taken by the Pennsylvania State Board of Accountancy. The Board's winter 1998-99 newsletter contains an article that conflicts with Act 140 - the CPA Law.

While Act 140 states that licensees would not be required to undergo a peer review "**until May 1, 2000**," the article claims that licensees "shall complete an on-site peer review **before** the biennial license period that begins May 1, 2000." In addition, the Board is requiring an off-site peer review before the biennial license period that begins May 1, 2004 for review engagements performed after May 1, 1998. In essence the Board will be requiring a peer review in 2004 on work that was performed six years prior.

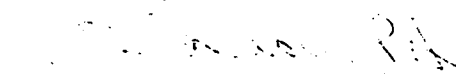
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I urge you to oppose the State Board's attempt to bypass the legislative process! Please uphold the original language that was passed by the Legislature in Act 140. That is, on-site peer review would not be required for audit engagements until May 1, 2000 for the engagements until May 1, 2004 for the license renewal in 2006.

Thank you for your support.

Sincerely,

R. C. Guarrry & Associates, Inc.

  
Richard C. Guarrry, P.A.

RCG:bcb

*George & Reck*  
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1999 SEP 21 AM 11:57  
FRED C. GEORGE, P.A.  
PHILIP R. RECK, P.A.  
REGISTERED IN PENNSYLVANIA  
INDEPENDENT REGULATORY  
REVIEW COMMISSION

March 19, 1999

Honorable Clarence D. Bell, Chairman-Senate Consumer Protection and Professional Licensure Committee

Dear Senator Bell:

I am writing in opposition to recent actions that have been taken by the Pennsylvania State Board of Accountancy. The Board's winter 1998 99 newsletter contains an article that conflicts with Act 140 - the CPA Law.

While Act 140 states that licensees would not be required to undergo a peer review "until May 1, 2000," the article claims that licensees "shall complete an on-site peer review before the biennial license period that begins May 1, 2000." In addition, the Board is requiring an off-site peer review before the biennial license period that begins May 1, 2004 for review engagements performed after May 1, 1998. In essence the Board will be requiring a peer review in 2004 on work that was performed six years prior.

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I urge you to oppose the State Board's attempt to bypass the legislative process! Please uphold the original language that was passed by the legislature in Act 140. That is, on-site peer review would not be required for audit engagements until May 1, 2000 for the license renewal in 2002; and off-site peer review would not be required for review engagements until May 1, 2004 for the license renewal in 2006.

Thank you for your support.

Sincerely,

GEORGE & RECK



Philip R. Reck  
Public Accountant



COMMONWEALTH OF PENNSYLVANIA  
DEPARTMENT OF STATE  
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September 21, 1999

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The Honorable John R. McGinley, Jr.  
Chairman, Independent Regulatory Review Commission  
Harristown II, 14<sup>th</sup> Floor  
333 Market Street  
Harrisburg, PA 17101

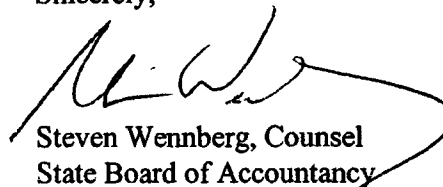
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RE: Proposed Rulemaking of the State Board of Accountancy  
Relating to Peer Review (16A-556)

Dear Chairman McGinley:

Enclosed for your Commission's information is a copy of a letter that the State Board of Accountancy received from the Pennsylvania Society of Public Accountants on September 17, 1999, regarding the above-referenced proposed rulemaking.

Sincerely,

  
Steven Wennberg, Counsel  
State Board of Accountancy

SW:apm  
Enclosure





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BPOA LEGAL COUNSEL

Steven Wennberg, Esq., Counsel  
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P.O. Box 2649  
Harrisburg, PA 17105-2649

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Dear Mr. Wennberg:

The Pennsylvania Institute of CPAs ("PICPA") appreciates the opportunity to comment on the Proposed Regulations to the CPA Law which were published in the Pennsylvania Bulletin, Volume 29, Number 34, dated August 21, 1999. This letter was prepared by the PICPA's Peer Review Committee ("the Committee") and represents, except where indicated, the consensus of the Committee, which is not necessarily the view of any individual member.

The Committee would like to commend the Board on its thorough drafting of regulations that will permit the Board to implement the peer review provisions of the new CPA law. The Committee is completely in favor of the proposed regulations. Additionally, we have the following comments with respect to the regulations and the accompanying explanatory information:

**Section 11.82. Effective dates for peer review compliance; proof of compliance or exemption.**

The PICPA was the driving force behind the legislation that became Act 140. As noted in the Board's explanatory comments, it was clearly the legislative intent of the bill's sponsors that peer reviews be required for firms performing audit engagements and for firms performing review engagements by May 1, 2000 and May 1, 2004, respectively. The PICPA has widely publicized the requirement and these due dates to its members, to other interested parties and to the general public. Such publicity included articles in our quarterly magazine, the distribution of various regular newsletters to members, and the publication of these matters on our web site. In addition, since the bill's enactment in early 1997, members of the PICPA have presented seminars sponsored by our organization as well as other organizations (including the Pennsylvania Society of Public Accountants, Penn State University and others) which have detailed the requirements of peer review including these effective dates. Furthermore, the Pennsylvania Society of Public Accountants has itself mailed at least two flyers announcing these proposed effective dates during this time period. Therefore the Committee believes that the effected parties have received adequate advanced notice of the peer review requirements and we completely agree with the Board's interpretation of the effective dates.

We appreciate your consideration of our comments. We are available to discuss any of these comments with the Board or other interested parties at your convenience.

Very truly yours,

*James P. Keasey, CPA*  
James P. Keasey, CPA, Chairman  
Peer Review Committee

JPK:mm



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DEPARTMENT OF STATE  
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September 27, 1999

Hand-delivered

The Honorable John R. McGinley, Jr.  
Chairman, Independent Regulatory Review Commission  
Harristown II, 14<sup>th</sup> Floor  
333 Market Street  
Harrisburg, PA 17101

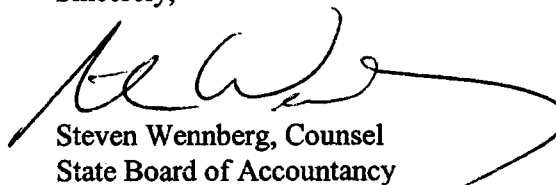
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RE: Proposed Rulemaking of the State Board of Accountancy  
Relating to Peer Review (16A-556)

Dear Chairman McGinley:

Enclosed for your Commission's information is a copy of a letter that the State Board of Accountancy received today from the Pennsylvania Institute of Certified Public Accountants regarding the above-referenced proposed rulemaking.

Sincerely,



Steven Wennberg, Counsel  
State Board of Accountancy

SW:apm  
Enclosure

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**Regulation 16A-556**

**State Board of Accountancy**

**PROPOSAL:** Regulation 16A-556 amends 49 PA Code, Chapter 31, regulations of the State Board of Accountancy. The amendments would add Sections 11.81-11.86 to current regulations to implement Section 8.9 of the CPA Law, 63 P.S. Sec. 9.8i, which was added by the Act of December 4, 1996, P.L. 851 (Act 140 of 1996). The provision requires licensed public accounting firms and sole practitioners to undergo a peer review as a condition of license renewal.

The proposed Rulemaking was published in the Pennsylvania Bulletin on August 21, 1999. The Professional Licensure Committee has until October 12, 1999 to submit comments on the regulation.

**ANALYSIS:** New Section 11.81 defines "Administering organization" as an entity that meets the standards specified by the Board for administering a peer review program. "Firm" is defined as a licensee who is a sole practitioner or a qualified association as defined in Section 2 of the act, 63 P.S. Sec. 9.2. "Peer reviewer" is defined as an individual who conducts an on-site or off-site peer review, including an individual who serves as captain of an on-site peer review team.

New Section 11.82 lists the effective dates for peer review compliance, and what must be provided to the Board for proof of compliance or exemption. A firm that performs an audit engagement after May 1, 1998 must complete a peer review before the license biennium that begins May 1, 2000. A firm that performs a review engagement but not an audit engagement after May 1, 1998 must complete a peer review before the license biennium that begins May 1, 2004. As proof of a firm's completion of peer review, a letter from the peer review administering organization must be submitted with the firm's application for initial licensure or license renewal. A firm claiming an exemption under Section 8.9(g) of the act must submit with its application information that substantiates its entitlement to an exemption. A multi-state firm which claims an exemption for having undergone a peer review in another state must submit a letter from the out-of-state peer review organization evidencing the firm's completion of peer review within three years prior to the date of application, which meets the requirements of the act. The firm must also submit a statement that the firm's personnel from an out-of-state office perform an inspection of the firm's Pennsylvania offices at least once every three years.

The proposed dates for peer review compliance would appear to be in conflict with the dates set forth in the act. Section 8.9(l)(2) of the act provides as follows: "This section shall not become

applicable to firms and no firm shall be required to undergo a peer review under this section until May 1, 2000, except that this section shall not become applicable until May 1, 2004, to a firm that has not accepted or performed any audit engagements during the period May 1, 1998, through April 30, 2004." The Board assert that Section 8.8(c) of the act is controlling as to the time for peer review compliance. That section provides that "An initial or renewal license shall not be issued to a firm after April 30, 2000 unless the firm complies with the requirements of Section 8.9 of this act." However, pursuant to Section 8.9(1)(2), Section 8.9 does not become applicable until May 1, 2000.

New Section 11.83 lists the organizations which the Board deems qualified to administer peer review programs. These include the Securities and Exchange Commission Practice Section and the Private Companies Practice Section of the American Institute of Certified Public Accountants (AICPA), and any state society or institute that participates in the AICPA Peer Review Program. A firm that is subject to peer review will not be required to become a member of the AICPA or any other administering organization.

New Section 11.84 provides that a peer review shall be conducted in accordance with the "Standards for Performing and Reporting on Peer Reviews," including interpretations thereof, issued by the AICPA.

New Section 11.85 sets forth the qualifications for peer reviewers. A peer reviewer shall possess the qualifications set forth in the Standards for Performing and Reporting on Peer Reviews," including interpretations thereof, issued by the AICPA. A licensed public accountant is also qualified if he or she otherwise satisfies the above requirements, as is a sole practitioner with a public accounting or auditing practice if the practitioner is also enrolled in a peer review program. A peer reviewer must be independent from and have no conflict of interest with the firm being reviewed.

New Section 11.86 provides that all peer review reports and related information shall remain confidential except as provided in Section 8.9(e) and (h)(3) of the act. Section 8.9(e) relates to procedures to be followed if a firm fails to comply with any remedial actions determined to be appropriate by the peer review administering organization. Section 8.9(h)(3) list three exceptions to the confidentiality privilege. These are: (i) For information presented or considered in the peer review process that was otherwise available to the public; (ii) For material not prepared in connection with a peer review merely because they subsequently are presented or considered as part of the peer review process; and (iii) In connection with an administrative proceeding or related civil action brought for the purpose of enforcing this section. The Board also has the right to inquire of an administering organization whether a peer review report has been accepted.

**RECOMMENDATIONS:** It is recommended that the Professional Licensure Committee take no formal action until final form regulations are promulgated. However, the committee offers the following comments:

The Committee is opposed to proposed Section 11.82 in that the dates set forth for peer review in that section are in conflict with the statutory language of and legislative intent behind Act 140 of

1996. In reviewing the plain language of Act 140, as well as a number of documents which explained the provisions of the act prior to its passage, the Committee finds that the legislative intent was for May 1, 2000 to be the starting date for the peer review program, and not the deadline for peer review compliance. Section 8.9(1)(2) of the act clearly provides as follows:

“This section shall not become applicable to firms and no firm shall be required to undergo a peer review under this section **until** May 1, 2000, except that this section shall not become applicable **until** May 1, 2004, to a firm that has not accepted or performed any audit engagements during the period May 1, 1998 through April 30, 2004.”

The Board states that its interpretation of the act is consistent with the position of the Pennsylvania Institute of Certified Public Accountant (PICPA), which the Board identifies as the organization which spurred the introduction of this legislation. However, the Committee has reviewed a letter dated April 4, 1996, authored by William Clark, Esq., an attorney who assisted in drafting the legislation. The letter purports to explain certain provisions of House Bill 1782, which was eventually passed as Act 140. The letter clearly states that “Firms that perform audits will be required to participate in the peer review program **beginning** May 1, 2000. Firms that perform reviews, but do not perform audits, will be required to participate in the peer review program **beginning** May 2004.”

Additionally, the Committee has reviewed an analysis of House Bill 1782, prepared by Charles E. McDonald, Esq., who was at the time the Executive Director of the House Professional Licensure Committee. The analysis was prepared for the purpose of informing members of the House of the provisions and legal ramifications of the bill prior to a vote on the measure. The analysis states that “The bill was amended in committee to change the requirement that firms which perform audits will be required to participate in the peer review program **beginning** May 1, 2000. Firms which perform reviews, but do not perform audits, will be required to participate in the peer review program **beginning** May 1, 2004.”

The Board states that the deadlines for peer review compliance have been well publicized by the PICPA. The Committee questions the Board’s reliance on the PICPA for the dissemination of this information to licensees. The Committee notes that the first time the Board notified licensees of its interpretation of the deadlines for peer review compliance was in its Winter 1998/99 newsletter. It is further noted that the Committee then advised the Board by letter dated March 23, 1999 of the Committee’s position on this issue.

Finally, Section 8.9c of the act provides that “The board shall adopt regulations establishing guidelines for peer reviews...” Act 140 was enacted in 1996, yet the Board did not publish proposed rulemaking on this subject until August 21, 1999. In the interim, licensees had no guidance as to who would be approved by the Board as peer review organizations. As of that date, there were less than nine months left for licensees to comply with peer review in accordance with the deadline proposed by the Board. There will be even less time for compliance by the time final regulations are in place, if in fact they are in place by the time of the Board’s proposed deadline.

House of Representatives  
Professional Licensure Committee  
September 30, 1999

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INDEPENDENT REGULATORY  
COMMISSION

AICPA

# Standards for Performing and Reporting on Peer Reviews

(Including  
Interpretations Issued  
Through January 1, 1997)

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

## NOTICE TO READERS

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

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

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

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

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**Introduction**

1. Quality in the performance of accounting and auditing engagements by AICPA members is the goal of the AICPA peer review program. The program seeks to achieve its goal through education and remedial, corrective actions. This goal serves the public interest and, at the same time, enhances the significance of AICPA membership.
2. Firms in the AICPA peer review program need to --
  - a. Establish and maintain appropriate quality control policies and procedures and comply with them to ensure the quality of their practices.
  - b. Have independent peer reviews of their accounting and auditing practices at least once every three years.
  - c. Take remedial, corrective actions as needed.
3. Statement on Quality Control Standards (SQCS) No. 2, *System of Quality Control for a CPA Firm's Accounting and Auditing Practices* (AICPA, *Professional Standards*, vol. 2, QC sec. 20), requires every CPA firm, regardless of its size, to have a system of quality control for its accounting and auditing practice. It identifies five elements of quality control and states that the nature, extent, and formality of a firm's quality control policies and procedures should be appropriately comprehensive and suitably designed in relation to the firm's size, the number of its offices, the degree of operating autonomy allowed its personnel and its offices, the knowledge and experience of its personnel, the nature and complexity of the firm's practice, and appropriate cost-benefit considerations.
4. An accounting and auditing practice for the purposes of the AICPA's *Standards for Performing and Reporting on Peer Reviews* is defined as all engagements covered by Statements on Auditing Standards (SASs); Statements on Standards for Accounting and Review Services (SSARSs); the Statement on Standards for Attestation Engagements (SSAE) *Financial Forecasts and Projections* (AICPA, *Professional Standards*, vol. 1, AT sec. 200); attest services on financial information when the firm audits, reviews, or compiles the historical financial state-

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

### General Considerations

#### Enrollment Requirements

8. The ownership of firms enrolled or seeking enrollment in the AICPA peer review program should comply with Council resolutions (AICPA, *Professional Standards*, vol. 2, ET Appendix B). In addition, at least one of the firm's owners has to be a member of the AICPA.

#### Confidentiality

9. A peer review should be conducted in compliance with the confidentiality requirements set forth by the AICPA in the section of the Code of Professional Conduct titled "Confidential Client Information" (AICPA, *Professional Standards*, vol. 2, ET sec. 301). Information concerning the reviewed firm or any of its clients or personnel, including the findings of the review, that is obtained as a consequence of the review is confidential. Such information should not be disclosed by review team members to anyone not involved in carrying out the review or administering the program, or used in any way not related to meeting the objectives of the program.

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

#### Independence, Integrity, and Objectivity

11. Independence (in fact and in appearance) should be maintained with respect to the reviewed firm by a reviewing firm, by review team members, and by any other individuals who participate in or are associ-

\* The exhibit on pages 22 and 33 includes summarized information from the AICPA's PCPS publication *What You Need to Know About Membership in the Private Companies Practice Section (PCPS): Addressing Actions, Actions* concerning the Private Companies Practice Section membership requirements and additional peer review requirements.

2. The objectives of the AICPA peer review program are achieved through the performance of peer reviews involving procedures tailored to the size of the firm and the nature of its practice. Firms that perform audits of historical financial statements, agreed-upon procedures under SAS No. 75, *Engagements to Apply Agreed-Upon Procedures to Specified Elements, Accounts, or Items of a Financial Statement* (AICPA, *Professional Standards*, vol. 1, AU sec. 622), or examinations of prospective financial statements have on-site peer reviews. Firms that perform services listed in paragraph 4 that are not required to have on-site peer reviews have off-site peer reviews. Firms that do not provide any of the services listed in paragraph 4 are not reviewed.

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

4. The program is based on the principle that a systematic monitoring and educational process is the most effective way to attain high-quality performance throughout the profession. Thus, it depends on mutual trust and cooperation. The reviewed firm is expected to take appropriate actions in response to deficiencies in its system of quality control, its compliance with that system, or both. These actions will be positive and remedial. Disciplinary actions (including actions that can result in the termination of a firm's enrollment in the peer review program or membership in the Private Companies Practice Section (PCPS) of the AICPA Division for CPA Firms, and the subsequent loss of membership in the AICPA and some state CPA societies by its owners and employees) will be taken only for a failure to cooperate or for deficiencies that are so serious that remedial or corrective actions are not suitable.

5. The objectives of the AICPA peer review program are achieved through the performance of peer reviews involving procedures tailored to the size of the firm and the nature of its practice. Firms that perform audits of historical financial statements, agreed-upon procedures under SAS No. 75, *Engagements to Apply Agreed-Upon Procedures to Specified Elements, Accounts, or Items of a Financial Statement* (AICPA, *Professional Standards*, vol. 1, AU sec. 622), or examinations of prospective financial statements have on-site peer reviews. Firms that perform services listed in paragraph 4 that are not required to have on-site peer reviews have off-site peer reviews. Firms that do not provide any of the services listed in paragraph 4 are not reviewed.

### Administration of Reviews

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

### Organization of the Review Team

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

17. A review team comprises one or more individuals, depending upon the size and nature of the reviewed firm's practice. One member of the review team is designated the team captain. That individual is responsible for supervising and conducting the review, communicating the review team's findings to the reviewed firm and to the state CPA society administering the review, and preparing the report and, if applicable, the letter of comments on the review. The team captain should supervise and review the work performed by other reviewers on the review team to the extent deemed necessary in the circumstances.

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

ated with the review. In addition, the review team should perform all peer review responsibilities with integrity and maintain objectivity in discharging those responsibilities.

12. *Independence* encompasses an impartiality that recognizes an obligation for fairness not only to the reviewed firm but also to those who may use the review team's peer review report on the reviewed firm. The reviewing firm, the review team, and any other individuals who participate on the peer review should be free from any obligation to or interest in the reviewed firm or its personnel. The concepts in the AICPA Code of Professional Conduct's Article III, "Integrity," and Article IV, "Objectivity and Independence" (AICPA, *Professional Standards*, vol. 2, ET secs. 54 and 55), should be considered in making independence judgments. In that connection, the specific requirements set forth in appendix A apply. *Integrity* requires the review team to be honest and candid within the constraints of the reviewed firm's confidentiality. Service and the public trust should not be subordinated to personal gain and advantage. *Objectivity* is a state of mind and a quality that lends value to a review team's services. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest.

### Competence

13. A review team conducting a peer review should have current knowledge of the professional standards applicable to the type of practice to be reviewed. Individuals reviewing engagements should have recent experience in the industries of the engagements selected for review. See paragraph 16 for a description of the qualifications an individual should possess to serve on a review team.

### Due Professional Care

14. Due professional care as addressed by the AICPA Code of Professional Conduct in Article V, "Due Care" (AICPA, *Professional Standards*, vol. 2, ET sec. 56), should be exercised in performing and reporting on the review. This imposes an obligation on all those involved in carrying out the review to fulfill assigned responsibilities in a professional manner.

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## Qualifications for Service as a Reviewer

### General

18. Performing and reporting on a peer review requires the exercise of professional judgment by peers. (See paragraphs 85 through 91 for a discussion of a reviewer's responsibilities when performing a peer review.) Accordingly, an individual serving as a reviewer (whether for an on-site or off-site peer review)<sup>1</sup> should —

- a. Be a member of the AICPA licensed to practice as a certified public accountant with an enrolled firm that, if reviewed, has received an unqualified report on its system of quality control or its off-site peer review.
- b. Possess current knowledge of applicable professional standards. This includes knowledge about current rules and regulations applicable to the industries for which engagements are reviewed. Such knowledge may be obtained from on-the-job training, training courses, or a combination of both.
- c. Have at least five years of recent experience<sup>2</sup> in the practice of public accounting in the accounting or auditing function.
- d. Be currently active in public practice at a supervisory level in the accounting or auditing function<sup>3</sup> of a firm enrolled in an approved practice-monitoring program (that is, a firm enrolled in the AICPA peer review program or a firm that is a member of the AICPA

<sup>1</sup> See the exhibit on pages 32 and 33 for additional qualifications needed by individuals performing reviews of firms in the Private Companies Practice Section.

<sup>2</sup> For this purpose, recent means having experience in the industries for which engagements are reviewed within the last five years. However, a reviewer should be cautious of those high-risk industries or industries whose new standards have been implemented. For example, in those cases where new industry standards or practices have occurred in the most recent year, it may be necessary to have current practice experience in that industry in order to have recent experience.

<sup>3</sup> The AICPA Peer Review Board recognizes that practitioners often perform a number of functions, including tax and consulting work, and cannot restrict themselves to accounting and auditing work. This Standard is not intended to require that reviewers be individuals who spend all their time on accounting and auditing engagements. However, CPAs who wish to serve as reviewers should carefully consider whether their day-to-day involvement in accounting and auditing work is sufficiently comprehensive to enable them to perform a peer review with professional expertise. For instance, a reviewer of auditing engagements should ordinarily be currently reviewing or performing auditing engagements.

Division for CPA Firms) as an owner of the firm or as a manager or person with equivalent supervisory responsibilities. To be considered currently active in the accounting or auditing function, a reviewer should be currently involved in the accounting or auditing practice of a firm supervising one or more of the firm's accounting or auditing engagements or carrying out a quality control function on the firm's accounting or auditing engagements.

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

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

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

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

Standards for Performing and Reporting on Peer Reviews

**On-Site Team Captain**

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

**Off-Site Reviewer**

24. In addition to adhering to the general requirements for a reviewer, an individual serving as a reviewer on an off-site peer review (available to firms that perform no audits of historical financial statements, agreed-upon procedures under SAS No. 75, or examinations of prospective financial statements) should —
- Have completed a training course or courses that meet requirements established by the AICPA Peer Review Board.
  - Be associated with a firm that has received, on its most recently completed peer review, either an unqualified report on its system of quality control or an unqualified report on its off-site peer review. If the individual is associated with more than one firm, then each of the firms the individual is associated with should have received an unqualified report on its most recently completed peer review of its accounting practice.

**Performing On-Site Peer Reviews**

**Objectives**

25. An on-site peer review is intended to provide the reviewer with a reasonable basis for expressing an opinion on whether, during the year under review —
- The reviewed firm's system of quality control for its accounting and auditing practice has been designed in accordance with quality con-

Standards for Performing and Reporting on Peer Reviews

26. Firms that perform audits of historical financial statements, agreed-upon procedures under SAS No. 75, or examinations of prospective financial statements have on-site peer reviews because of the public interest in the quality of such engagements and the importance to the accounting profession of maintaining the quality of those services.
- Just as the performance of an audit includes audit risk, the performance of an on-site peer review includes peer review risk. Peer review risk is the risk that the review team —
    - Fails to identify significant weaknesses in the reviewed firm's system of quality control for its accounting and auditing practice, its compliance with that system, or both.
    - Issues an inappropriate opinion on the reviewed firm's system of quality control for its accounting and auditing practice, its compliance with that system, or both.
    - Reaches an inappropriate decision about the findings to be included in or excluded from the letter of comments, or about whether to issue a letter of comments.
28. Peer review risk consists of the following two parts:
- The risk (consisting of inherent risk<sup>1</sup> and control risk<sup>2</sup>) that an engagement will fail to comply with professional standards, that the

**Peer Review Risk**

- <sup>1</sup> Inherent risk is the likelihood that an accounting or auditing engagement will fail to comply with professional standards, assuming the firm does not have a system of quality control.
- <sup>2</sup> Control risk is the risk that a firm's system of quality control will not prevent the performance of an engagement that does not comply with professional standards. (It consists

(continued)

*Standards for Performing and Reporting on Peer Reviews* 11

the nature and extent of the tests to be applied in the functional areas (see paragraphs 43 through 49).

- b. Perform the review, as follows:
  1. Review compliance by the firm with its system of quality control. The review should cover all organizational or functional levels within the firm.
  2. Review selected engagements, including the relevant working paper files and reports (see paragraphs 50 through 54).
  3. If applicable, review compliance with the membership requirements of the Private Companies Practice Section (see the exhibit on pages 32 and 33).
  4. Reassess the adequacy of the scope of the review based on the results obtained to determine if additional procedures are necessary.
  5. Have an exit conference with senior members of the reviewed firm and at least the team captain to discuss the review team's findings and recommendations and the type of report it will issue (see paragraph 55).
  6. Prepare a written report on the results of the review and, if applicable, a letter of comments (see paragraphs 63 through 68 and 71 through 76).
  7. Review and comment to the reviewed firm on the firm's response to the letter of comments, if any (see paragraph 77).

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

**Scope of the Review**

32. The review should cover a firm's accounting and auditing practice as defined in paragraph 4. It should be directed to the professional aspects of the firm's accounting and auditing practice; it should not

10 *Standards for Performing and Reporting on Peer Reviews*

reviewed firm's system of quality control will not prevent such failure, or both

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

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

**Basic Requirements**

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

- a. Plan the review, as follows:
  1. Obtain a sufficient understanding of the nature and extent of the firm's accounting and auditing practice to plan the review (see paragraph 38).
  2. Obtain a sufficient understanding of the design of the firm's system of quality control, including an understanding of the monitoring procedures performed since the prior review, to plan the review (see paragraph 40).
  3. Assess the peer review risk (see paragraphs 41 and 42).
  4. Use the knowledge obtained from the foregoing to select the offices and the engagements to be reviewed, and to determine

of two parts: the firm's control environment and its quality control policies and procedures. The control environment represents the collective effort of various factors on establishing, enhancing, or mitigating the effectiveness of specific quality control policies and procedures. The control environment reflects the overall attitude, awareness, and actions of firm management concerning the importance of quality work and its emphasis in the firm.

*Standards for Performing and Reporting on Peer Reviews* 13

for a scope limitation. In all other circumstances, the review team should carefully assess the effects the divestiture has on the scope of the peer review. A review team captain who is considering whether a peer review report should be modified for a scope limitation due to a divestiture should consult with the state CPA society administering the review.

37. A reviewed firm may have legitimate reasons for not permitting the working papers for certain engagements to be reviewed. For example, the financial statements of an engagement selected for review may be the subject of litigation or investigation by a government authority, or the firm may have been advised by a client that it will not permit the working papers for its engagement to be reviewed. In such circumstances, the review team should satisfy itself as to the reasonableness of the explanation. Also, in order to reach a conclusion that the excluded engagements do not have to be reported as a scope limitation, the review team needs to consider the number, size, and relative complexity of the excluded engagements, and should review other engagements in a similar area of practice as well as other work of the supervisory personnel who participated in the excluded engagements.

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

**Understanding Accounting and Auditing Practice and System of Quality Control**

39. The review team should obtain a sufficient understanding of the nature and extent of the reviewed firm's accounting and auditing practice to plan the review. This understanding should include knowledge about the reviewed firm's organization and philosophy, and the composition of its accounting and auditing practice. This knowledge is ordinarily obtained through such procedures as inquiries of appropriate manage-

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include the business aspects of that practice. Moreover, review team members should not have contact with or access to any client of the reviewed firm in connection with the review.

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

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

35. The team captain should obtain the report on the last review of the firm and, if applicable, the letter of comments and the response thereto, and the letter accepting those documents. The team captain should consider whether the matters discussed in those documents require additional emphasis in the current review, and in the course of the review should evaluate the actions of the firm in response to the prior report and letter of comments.

36. A divestiture of a portion of the practice of a reviewed firm during the year under review may have to be reported as a scope limitation if the review team is unable to assess compliance for reports issued under the firm's name during that year. If the review team is able to review engagements of the divested portion of the reviewed firm's practice, then the review team should review such engagements considered necessary to obtain an appropriate scope for the peer review. In such circumstances, an appropriate scope is one in which the review covers all owners and significant industry areas that existed prior to the divestiture. If the divested portion of the practice is unavailable for review and represents less than ten percent of the reviewed firm's accounting and auditing hours, then the review team does not have to modify the report

ment personnel and requests of management to provide certain background information, some of which will have been provided to the review team before the review was accepted.

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

#### Assessing Peer Review Risk

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

42. When assessing risk, the review team should evaluate the reviewed firm's quality control policies and procedures over its accounting and auditing practice in relation to the requirements contained in SQCS No. 2. This evaluation provides a basis for the review team to determine whether the reviewed firm has adopted appropriately com-

prehensive and suitably designed policies and procedures that are relevant to the size and nature of its practice. When making the evaluation, the review team should discuss with the firm how it considered the guidance provided in the AICPA's *Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice*.

#### Extent of Compliance Tests

43. Based on its understanding of the reviewed firm's accounting and auditing practice and system of quality control, and its assessment of peer review risk, the review team should consider whether any modifications to the programs and checklists issued by the AICPA Peer Review Board are appropriate. The team captain should then develop a general plan for the conduct of the review, including the nature and extent of compliance tests. The compliance tests should be tailored to the practice of the reviewed firm and, taken as a whole, should be sufficiently comprehensive to provide a reasonable basis for concluding whether the reviewed firm's system of quality control was complied with to provide the firm with reasonable assurance of conforming with professional standards in the conduct of its accounting and auditing practice. Such tests should be performed at the practice office(s) visited and should relate either to broad functions or to individual engagements. The tests should include —

- a. Reviewing selected engagements, including working paper files and reports, to evaluate their conformity with professional standards and compliance with relevant firm quality control policies and procedures.
- b. Interviewing firm professional personnel at various levels and, if applicable, other persons responsible for a function or activity, to assess their understanding of and compliance with the firm's quality control policies and procedures.
- c. Reviewing evidential matter to determine that the firm has complied with its policies and procedures for monitoring its system of quality control.
- d. Reviewing other evidential matter as appropriate — for example, selected administrative or personnel files, correspondence files documenting consultations on technical or ethical questions, files evidencing compliance with professional development requirements, and the firm's library.



### Selection of Offices

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

- Number, size, and geographic distribution of offices
- The degree of centralization of accounting and auditing practice control and supervision
- The review team's evaluation, where applicable, of the firm's monitoring procedures
- Recently merged or recently opened offices
- The significance of industry concentrations and of specialty practice areas, such as governmental compliance audits or regulated industries, to the firm and to individual offices

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

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

### Selection of Engagements

46. When combined with other procedures performed, the number and type of accounting and auditing engagements selected by the review team for review should be sufficient to provide the review team with a reasonable basis for its conclusions regarding whether the reviewed firm's system of quality control has been designed in accordance with the quality control standards for an accounting and auditing practice established by the AICPA and was being complied with during the year under review.

47. Engagements selected for review should provide a reasonable cross section of the reviewed firm's accounting and auditing practice.

with greater emphasis on those engagements in the practice with higher assessed levels of peer review risk. Examples of the factors to consider when assessing peer review risk at the engagement level include: size, industry area, level of service, personnel (turnover, use of merged-in personnel) or personnel not routinely assigned to accounting and auditing engagements, litigation in industry area, and initial engagement.

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

49. The process of engagement selection, like office selection, is not subject to definitive criteria. However, if the team captain finds that meeting all of the criteria discussed above causes the selection of an inappropriate scope of the firm's accounting and auditing practice, the team captain may want to consult with the state CPA society administering the review about the selection of engagements for review. In such circumstances, the team captain should carefully consider whether —

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

### Extent of Engagement Review

50. The review of engagements should include review of financial statements, accountants' reports, working paper files, and correspon-

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

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

51. For each engagement reviewed, the review team should document whether anything came to its attention that caused it to believe that —
- The financial statements were not presented in all material respects in accordance with generally accepted accounting principles or, if applicable, an other comprehensive basis of accounting.
  - The firm did not have a reasonable basis under applicable professional standards for the report issued.
  - The documentation on the engagement did not support the report issued.
  - The firm did not comply with its quality control policies and procedures in all material respects.

52. If the review team answers yes with respect to any of the above items, the team captain should promptly inform an appropriate member of the reviewed firm (generally on a "Matter for Further Consideration" form). The reviewed firm should investigate the matter questioned by the review team and determine what action, if any, should be taken. If the reviewed firm concludes that its report on previously issued financial statements is inappropriate, as addressed in the sections of SAS No. 1 titled "Subsequent Discovery of Facts Existing at the Date of the Auditor's Report" (AICPA, *Professional Standards*, vol. 1, AU sec. 561), or the firm's work does not support the report issued, as addressed in SAS No. 46, *Consideration of Omitted Procedures After the Report Date* (AICPA, *Professional Standards*, vol. 1, AU sec. 380), the reviewed firm should take timely action, as appropriate, to correct such engagements. The reviewed firm should advise the team captain of the results of its investigation and document the actions taken or planned or its reasons for concluding that no action is required (generally on the "Matter for Further Consideration" form prepared by the reviewer).

53. If the reviewed firm believes that it can continue to support its previously issued report and the review team continues to believe that there may be a significant failure to reach appropriate conclusions in the application of professional standards, the review team should pursue any

remaining questions with the reviewed firm and, if necessary, with the state CPA society administering the review. The review team should also consider whether it is necessary to expand the scope of the review by selecting additional engagements to determine the extent and cause of significant departures from professional standards.

54. In evaluating the reviewed firm's response, the review team should recognize that it has not audited the financial statements in question in accordance with generally accepted auditing standards and that it has not had the benefit of access to client records, discussions with the client, or specific knowledge of the client's business. Nevertheless, a disagreement on the resolution of the matter may persist in some circumstances and the reviewed firm should be aware that the state CPA society administering the review may refer unresolved matters to the AICPA Peer Review Board for a final determination.

#### Exit Conference

55. Prior to issuing its report and, if applicable, letter of comments, the review team should communicate its conclusions to senior members of the reviewed firm at an exit conference, which may also be attended by representatives of state CPA society administering entities, the AICPA Peer Review Board, or other authorized organizations with oversight responsibilities. The reviewed firm is entitled to be informed at the exit conference about any matters that may affect the review report and about the findings and recommendations that will be included in the letter of comments. Accordingly, except in rare circumstances that should be explained to the reviewed firm, the exit conference should be postponed if there is any uncertainty about the report to be issued or the matters to be included in the letter of comments. The exit conference is also the appropriate vehicle for providing suggestions to the firm that do not have an effect on the report or letter of comments.

#### Performing Off-Site Peer Reviews

##### Objectives

56. The objective of an off-site peer review is to provide the reviewer with a reasonable basis for expressing limited assurance that the financial

statements or information and the related accountant's report on the accounting and review engagements and attestation<sup>17</sup> engagements submitted for review, conform in all material respects with the requirements of professional standards. This objective is different from the objectives of an on-site peer review in recognition of the fact that off-site peer reviews are available only to firms that perform no audits of historical financial statements, agreed-upon procedures under SAS No. 75, or examinations of prospective financial statements. Firms required to have an off-site peer review may elect to have an on-site peer review. Compliance with the positive enforcement program of a state board of accountancy does not constitute compliance with the AICPA practice-monitoring requirement.

### Basic Requirements

57. The criteria for selecting the peer review year end and the period to be covered by an off-site peer review are the same as those for an on-site peer review (see paragraphs 33 and 34). The reviewed firm shall provide summarized information showing the number of its accounting and review engagements and attestation<sup>17</sup> engagements, classified into major industry categories. That information should be provided for each owner of the firm who is responsible for the issuance of reports on accounting and review services and attest services. On the basis of that information, the reviewer or the state CPA society administering the review ordinarily should select the types of engagements to be submitted for review, in accordance with the following guidelines:

- a. One engagement should be selected from each area of service performed by the firm:
  1. Review on historical financial statements
  2. Compilation on historical financial statements, with disclosures
  3. Compilation on historical financial statements that omit substantially all of the disclosures required by generally accepted accounting principles or an other comprehensive basis of accounting

<sup>17</sup>See paragraph 4 for a description of the types of attestation engagements included within the definition of an accounting and auditing practice for peer review purposes. The attestation engagement selected for review can be on either prospective financial statements or assertions.

<sup>18</sup>See note 10.

#### 4. Attestation<sup>17</sup>

- b. One engagement should be selected from each owner of the firm responsible for the issuance of reports listed in a above.
- c. Ordinarily, at least two engagements should be selected for review.

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

58. For each engagement selected for review, the reviewed firm shall submit the appropriate financial statements or information and the accountant's report, masking client identity if it desires, along with specified background information and representations about each engagement. If the reviewed firm is a member of the Private Companies Practice Section, the reviewed firm shall also submit information concerning its compliance with the section's membership requirements (see the exhibit on pages 32 and 33).

59. An off-site peer review consists only of reading the financial statements or information submitted by the reviewed firm and the accountant's report thereon, together with certain background information and representations provided by the reviewed firm. The objective of the review of these engagements is to consider whether the financial statements or information and the accountant's report appear to be in conformity with professional standards. An off-site peer review does not include a review of the working papers prepared on the engagements submitted for review, tests of the firm's administrative or personnel files, interviews of selected firm personnel, or other procedures performed in an on-site peer review.

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

61. A firm that has an off-site peer review should respond promptly to questions raised in the review, whether those questions are raised orally

<sup>18</sup>See note 10.

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or in writing on a "Matter for Further Consideration" form. The reviewer will contact the firm, before issuing the review report, to resolve questions raised in the review.

62. The reviewer performing an off-site peer review should document the work performed using the programs and checklists issued by the AICPA Peer Review Board for that purpose. Failure to complete all relevant programs and checklists in a professional manner creates the presumption that the review has not been performed in conformity with these Standards. Such a review cannot be accepted as meeting the requirements of the peer review program.

**Reporting on Reviews**

**General**

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

64. The team captain or, where provided by its plan of administration, an authorized association of CPA firms should notify the state CPA society administering the review that the review has been completed and should submit to that state CPA society within thirty days of the exit conference date or by the firm's peer review due date, whichever date is earlier, a copy of the report and letter of comments, if any, and the working papers specified in the programs and checklists issued by the AICPA Peer Review Board.

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

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

66. The reviewed firm should not publicize the results of the review or distribute copies of the report to its personnel, its clients, or others until it has been advised that the report has been accepted by the state CPA society administering the review as meeting the requirements of the AICPA peer review program. Neither the state CPA society nor the AICPA shall make the results of the review available to the public,<sup>12</sup> but on request may disclose the following information:

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

**Reports on On-Site Peer Reviews**

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

<sup>12</sup>If the firm is a member of the Private Companies Practice Section, the section's membership requirements provide that a copy of the report, letter of comments, if any, and the firm's response thereto be placed in the public files of the AICPA Division for CPA Firms (see the exhibit on pages 38 and 39).

with the membership requirements of the section in all material respects and, if applicable, describe the reason(s) for any qualification of the opinion.

68. A team captain may issue an unqualified, qualified, or adverse report on the review. In deciding on the type of report to be issued, the team captain should be guided by the considerations discussed in appendix B. The standard form for an unqualified report is illustrated in appendix C. Illustrations of qualified and adverse reports are presented in appendix D.

### Reports on Off-Site Peer Reviews

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

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

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

### Letters of Comments

71. A letter of comments should be issued in connection with an on-site peer review when there are matters that resulted in qualification(s) to the standard form of report or when there are matters that the review

team believes resulted in conditions being created in which there was more than a remote possibility that the firm would not conform with professional standards on accounting and auditing engagements, or when a Private Companies Practice Section member firm has failed to comply with one or more of the section's membership requirements. The letter should provide reasonably detailed descriptions of the findings and recommendations so that the state CPA society administering the review can evaluate whether the actions taken or planned by the reviewed firm appear appropriate in the circumstances.

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

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

74. A letter of comments should be issued in connection with an off-site peer review when there are matters that resulted in qualification(s) to the standard form of report or when the reviewer notes other departures from professional standards that are not deemed to be significant departures but that should be considered by the reviewed firm in evaluating the quality control policies and procedures over its accounting practice, or when a Private Companies Practice Section member firm has failed to comply with one or more of the section's membership requirements. The letter should provide reasonably detailed descriptions of the findings and recommendations so that the state CPA society administering the review can evaluate whether the actions taken or planned by the reviewed firm appear appropriate in the circumstances.

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

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

review should make reference to the letter of comments. No reference should be made to the letter of comments in an unqualified report.

### Letters of Response

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

### Acceptance of Reviews

78. A committee or report acceptance body (hereafter, the committee) should be appointed by each participating state CPA society for the purpose of considering the results of reviews it administers that are undertaken to meet the requirements of the peer review program. The activities of the committee should be carried out in accordance with administrative procedures issued by the AICPA Peer Review Board. Committee members may not participate in any discussion or have any vote with respect to a reviewed firm when the member lacks independence or has a conflict of interest with the reviewing firm, the reviewer, or the reviewed firm.

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

- a. The review has been performed in accordance with these standards and related guidance materials.
- b. The report, letter of comments, if any, and the response thereto are in accordance with these Standards and related guidance material, including an evaluation of the adequacy of the corrective actions the reviewed firm has represented that it will take in its letter of response.

- c. It should require any remedial, corrective actions in addition to those described by the reviewed firm in its letter of response. Examples of such corrective actions are requiring certain individuals to obtain specified types and amounts of continuing professional education, requiring the firm to carry out more comprehensive monitoring procedures, or requiring it to engage another CPA to perform preissuance reviews of financial statements and reports, or to attempt to strengthen its professional staff.
- d. It should monitor the corrective actions implemented by the reviewed firm. Examples of monitoring procedures are requiring the firm to submit information concerning continuing professional education obtained by firm personnel, reports on the reviewed firm's monitoring of its practice, or reports by another CPA engaged to perform preissuance reviews of financial statements and reports. Revisits by team captains and accelerated peer reviews are other examples of monitoring procedures.

80. In reaching its conclusions on the above items, the committee is authorized to make whatever inquiries or initiate whatever actions it considers necessary in the circumstances, including requesting revision of the report, the letter of comments, or the reviewed firm's response. Such inquiries or actions by the committee should be made with the understanding that the peer review program is intended to be positive and remedial in nature, and is based on mutual trust and cooperation. Accordingly, in deciding on the need for and nature of any additional corrective actions or monitoring procedures, the committee should consider the nature, significance, pattern, and pervasiveness of engagement deficiencies. It should evaluate whether the recommendations of the review team appear to address those deficiencies adequately and whether the reviewed firm's responses to those recommendations appear comprehensive, genuine, and feasible.

81. If, after consideration of items 79a through 79d above, the committee concludes that no additional corrective actions are deemed necessary, the committee will accept the report and so notify the reviewed firm. If additional actions by the reviewed firm or if monitoring procedures are deemed necessary, the firm will be required to evidence its agreement in writing before the report is accepted.

82. In the rare event of a disagreement between the committee and the review team or the reviewed firm that cannot be resolved by ordinary good-faith efforts, the committee may request that the matter be

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

83. If a reviewed firm refuses to cooperate, fails to correct material deficiencies, or is found to be so seriously deficient in its performance that education and remedial, corrective actions are not adequate, the AICPA Peer Review Board may decide, pursuant to due process procedures that it has established, to appoint a hearing panel to consider whether the firm's enrollment in the AICPA peer review program should be terminated or whether some other action should be taken.

84. If a decision is made by the hearing panel to terminate a firm's enrollment in the AICPA peer review program, the firm will have the right to appeal to the AICPA Joint Trial Board for a review of the findings. The trial board will have the authority to confirm or to reduce the severity of the findings, but it will not have the authority to increase their severity. The fact that a firm's enrollment in the AICPA peer review program has been terminated shall be reported in an AICPA membership periodical.

## Evaluation of Reviewers

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

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

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

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

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

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

90. Corrective or monitoring actions can be appealed only to the committee that imposed the actions. For actions imposed or ratified by the AICPA Peer Review Board, if the reviewer disagrees with the corrective or monitoring action, he or she may appeal the decision by writing the AICPA Peer Review Board, and explaining why he or she believes that

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the actions are unwarranted. Upon receipt of the request, the AICPA Peer Review Board will review the request at its next meeting and take the actions it believes appropriate in the circumstances.

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

### Qualifications of Committee Members

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

- a. Currently active in public practice at a supervisory level in the accounting or auditing function of a firm enrolled in an approved practice-monitoring program as an owner of the firm or as a manager or person with equivalent supervisory responsibilities.
- b. Associated with a firm that has received an unqualified report on its most recently completed peer review.

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

### Effective Date

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

## Exhibit and Appendixes



94. Exhibit

**Additional Requirements for Members of the Private Companies Practice Section\***

1. A member of the Private Companies Practice Section of the AICPA Division for CPA Firms shall comply with the section's requirement for mandatory peer review by:
  - a. Having a review administered under the AICPA peer review program or, if it is or becomes a member of the SEC Practice Section of the AICPA Division for CPA Firms, a review administered by that section.
  - b. Complying with all of the standards and requirements of the applicable practice-monitoring program and with any additional requirements as may be established or modified from time to time by the Private Companies Practice Executive Committee.
2. The Private Companies Practice Executive Committee has established the following additional membership requirements.
  - a. Ensure that a super majority (85% percent) of the ownership of the firm in terms of financial interests and voting rights belongs to CPAs (firms not in compliance with this requirement have until May 1997 to ensure compliance), that the firm can legally engage in the practice of public accounting, and that each owner of the firm residing in the United States and eligible for AICPA membership is a member of the AICPA.
  - b. Adhere to the quality control standards established by the AICPA.
  - c. Ensure that all professionals in the firm residing in the United States, including CPAs and non-CPAs, take part in qualifying continuing professional education in one of the following ways.
    - (i) Participate in at least 120 hours every three years, but not less than twenty hours every year.
    - (ii) Comply with mandatory continuing professional education requirements for state licensing or for state CPA society membership, provided such state or society requirements require an average of forty hours per year of continuing professional education for each reporting period, and provided each professional in the firm participates in at least twenty hours every year.

\* This exhibit includes summarized information from the AICPA's publication *What You Need to Know About Membership in the Private Companies Practice Section (PCPS)*, Advisory, Activa, Atlanta.

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

**95. Appendix A****Independence Requirements****Reciprocal Reviews**

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

**Relationships With Clients of the Reviewed Firm**

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

**Relationships With the Reviewed Firm**

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

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

5. If arrangements exist between the reviewed firm and the reviewing firm or the firm of any member of the review team whereby fees, office facilities, or professional staff are shared, independence for the purposes of this program is impaired. Similarly, independence would be considered to be impaired by sharing arrangements involving, for example, frequent continuing education programs, extensive consultation, preissuance reviews of financial statements and reports, and audit and accounting manuals. In such circumstances, the firms

involved are sharing materials and services that are an integral part of their quality control systems. However, the impairment would be removed if an independent review was made of the shared materials (such as continuing education programs or an audit and accounting manual) before the peer review commenced and that independent review was accepted by the SEC Practice Section Peer Review Committee of the AICPA Division for CPA Firms before that date. (All quality control materials and CPE programs are accepted by the SECPS Peer Review Committee for both the SECPS and AICPA peer review programs. Therefore, firms that share materials and services are advised to consult with the SECPS peer review program if an independent review of such shared materials and services appears necessary.) Also, independence for the purposes of this program is not impaired by the performance of a review of a firm's quality control documents, of a preliminary quality control procedures review or consulting review, or an inspection.

## 96. Appendix B

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

#### Limitation on Scope of Review

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

#### The Nature and Significance of Engagement Deficiencies

2. The overriding objective of a system of quality control is to provide the firm with reasonable assurance of conforming with professional standards in the conduct of its accounting and auditing practice. When a review team encounters significant failures to reach appropriate conclusions, particularly those requiring the application of AICPA Statement on Auditing Standards (SAS) No. 46, *Consideration of Omitted Procedures After the Report Date* (AICPA, *Professional Standards*, vol. 1, AU sec. 300), and the section of SAS No. 1 entitled "Subsequent Discovery of Facts Existing at the Date of the Auditor's Report" (AICPA, *Professional Standards*, vol. 1, AU sec. 561), the team is faced with a clear indication that, in those engagements, the firm failed to conform with professional standards. The review team's first task in such circumstances is to try to determine the cause of the failure. Causes that might be systems-related and might affect the type of report issued include the following.

- The failure related to a specialized industry practice and the firm had no experience in that industry and made no attempt to acquire training in the industry or to obtain appropriate consultation and assistance.
- The failure related to a matter covered by a recent professional pronouncement and the firm had failed to identify, through professional development

programs or appropriate supervision, the relevance of that pronouncement to its practice.

- The failure should have been detected if the firm's quality control policies and procedures had been followed.
- The failure should have been detected by the application of quality control policies and procedures commonly found in firms similar in size or nature of practice. That judgment can often be made by the reviewer based on personal experience or knowledge; in some cases, the reviewer will wish to consult with the state CPA society administering the review before reaching such a conclusion.

3. The failure to conform with professional standards on an engagement may be the result of an isolated human error and, therefore, does not necessarily mean that the review report should be qualified or adverse. However, when the reviewer believes that the probable cause (for example, a failure to provide or follow appropriate policies for supervision of the work of assistants) of a significant failure to conform with professional standards on one engagement also exists in other engagements, the reviewer needs to consider carefully the need for a qualified or adverse report.

#### The Pattern and Pervasiveness of Engagement Deficiencies

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

### Design Deficiencies

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

### Noncompliance With Private Companies Practice Section Membership Requirements

6. If a firm is a member of the Private Companies Practice Section, the review team is required to evaluate whether the firm complied in all material respects with each of the membership requirements of the section. Although adherence to all membership requirements in every situation may not have been possible, a high degree of compliance is expected. In evaluating the significance of noncompliance with a membership requirement, the review team should recognize that those requirements directly related to the quality of performance on accounting and auditing engagements are more critical.

### Forming Conclusions

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

## 97. Appendix C

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

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

August 31, 19XX

To the Owners  
Able, Baker & Co.

or

To John B. Able, CPA

We<sup>†</sup> have reviewed the system of quality control for the accounting and auditing practice of [Name of Firm] (the firm) in effect for the year ended June 30, 19XX. Our review was conducted in conformity with standards established by the Peer Review Board of the American Institute of Certified Public Accountants (AICPA). We tested compliance with the firm's system of quality control to the extent we considered appropriate. These tests included a review of selected accounting and auditing engagements.

In performing our review, we have given consideration to the quality control standards for an accounting and auditing practice issued by the AICPA. Those standards indicate that a firm's quality control policies and procedures should be appropriately comprehensive and suitably designed in relation to the firm's size, organizational structure, operating policies, and the nature of its practice. They state that variance in an individual's performance and understanding of professional requirements or the firm's quality control policies and procedures can affect the degree of compliance with a firm's prescribed quality control policies and procedures and, therefore, the effectiveness of the system.

In our opinion, the system of quality control for the accounting and auditing practice of [Name of Firm] in effect for the year ended June 30, 19XX, has been

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

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

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

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

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

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

## 98. Appendix D Illustrations of Qualified and Adverse Reports on an On-Site Peer Review

### Report Qualified for Design Deficiency

*[Separate paragraph after the standard first two paragraphs]*

As discussed in our letter of comments under this date, our review disclosed that the firm's quality control policies and procedures for engagement performance regarding audit planning were not appropriately designed.

*[Opinion paragraph]*

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

### Report Qualified for Noncompliance With Quality Control Policies and Procedures

*[Separate paragraph after the standard first two paragraphs]*

As discussed in our letter of comments under this date, our review disclosed that the firm's quality control policies and procedures for engagement performance regarding completion of financial statement reporting and disclosure checklists were not followed.

*[Opinion paragraph]*

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

### Adverse Report

*[Separate paragraph after the standard first two paragraphs]*

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

checklists required by firm policy and failures to review engagement working papers in the manner required by firm policy.

**[Opinion paragraph]**

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

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

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

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

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

## 99. Appendix E Guidelines for and Illustration of a Letter of Comments on an On-Site Peer Review

### Guidelines

1. The objectives of the letter of comments on an on-site peer review are set forth in the Standards.
2. The letter should be addressed, dated, and signed in the same manner as the report on the on-site peer review, and should include the following:
  - a. A reference to the report on the review, indicating, where applicable, that the report was qualified or adverse
  - b. A description of the purpose of the on-site peer review
  - c. A statement that the review was performed in accordance with standards established by the Peer Review Board of the AICPA
  - d. A description of the limitations of a system of quality control
  - e. A statement that the matters discussed in the letter were considered in determining the opinion on the system of quality control
  - f. The findings on the review and related recommendations (This section should be separated between those findings, if any, that resulted in a qualified or adverse report and those that did not. In addition, the letter should identify, where applicable, any comments that were also made in the letter of comments issued on the firm's previous peer review.)
3. In addition to matters that resulted in a qualified or adverse report, which must always be included in the letter, the letter of comments should include, according to the Standards, "matters that the review team believes resulted in conditions being created in which there was more than a remote possibility that the firm would not conform with professional standards on accounting and auditing engagements, or when a Private Companies Practice Section member firm has failed to comply with one or more of the section's membership requirements." The letter should include comments on such matters even if they did not result in deficiencies on the engagements reviewed. When engagement deficiencies, particularly instances of nonconformity with professional standards, were attributable to deficiencies in the design of the firm's system of quality control or noncompliance with significant firm policies and procedures that are included in the letter, that fact should be noted in the comment.
4. Although isolated instances of noncompliance with the firm's quality control policies and procedures ordinarily would not be included in a letter of comments, their nature, importance, causes (if determinable), and implications

for the firm's system of quality control as a whole should be evaluated in conjunction with the review team's other findings before making a final determination.

### Illustration of a Letter of Comments

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

August 31, 19XX

To the Owners  
Able, Baker & Co.

or

To John B. Able, CPA

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

Our review was for the purpose of reporting upon the firm's system of quality control and its compliance with that system (and with the membership requirements of the Private Companies Practice Section).<sup>†</sup> Our review was conducted in conformity with standards established by the Peer Review Board of the American Institute of Certified Public Accountants; however, our review would not necessarily disclose all weaknesses in the system or all instances of noncompliance with it (and with the membership requirements of the section)<sup>†</sup> because our review was based on selective tests.

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

<sup>\*</sup> This phrase should be used only if a qualified or adverse report is being issued, and it should be tailored to fit the circumstances.

<sup>†</sup> This phrase should be used only if the reviewed firm is a member of the Private Companies Practice Section.

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

### Matters That Resulted in a Qualified Report<sup>\*</sup>

#### Engagement Performance

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

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

### Matters That Did Not Result in a Qualified Report<sup>\*</sup>

#### Engagement Performance

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

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

#### Monitoring

**Finding** — The firm's policies and procedures require that findings on engagements reviewed during the firm's annual inspection be summarized so that management can consider what types of actions, if any, are necessary. However, the firm did not summarize inspection findings from engagement reviews on the

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

most recent inspection, even though each engagement owner considered and responded to findings on their individual engagements.

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

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

## 100. Appendix F

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

The purpose of a letter of response is to describe the actions the firm has taken or will take to prevent a recurrence of each matter discussed in the letter of comments. If the reviewed firm disagrees with one or more of the findings or recommendations in the letter of comments, its response should describe the reasons for such disagreement. The letter of response should be carefully prepared because of the important bearing it may have on the decisions reached in connection with acceptance of the report on the review (see the section of these Standards on "Acceptance of Reviews"). If the firm has received a qualified or adverse report, the firm's responses should be separated between those findings that resulted in a qualified or adverse report and those that did not.

#### Sample Letter of Response

September 15, 19XX

*[Addressed to the state CPA society administering the review]*

Ladies and Gentlemen:

This letter represents our response to the letter of comments issued in connection with our firm's on-site peer review for the year ended June 30, 19XX. The matters discussed herein were brought to the attention of all professional personnel at a training session held on September 10, 19XX. In addition, the matters discussed in this letter will be monitored to ensure they are effectively implemented as a part of our system of quality control.

#### *Matters That Resulted in a Qualified Report\**

**Owner Involvement in Audit Planning** — The firm modified its quality control policies and procedures to require an owner to be involved in the planning stage of all audit engagements. In addition, we identified review engagements that are sufficiently large or complex to warrant owner involvement in the planning stage. The revised policies and procedures require the engagement owner to document his or her timely involvement in the planning process in the planning section of the written work program. The importance of proper planning,

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



including timely owner involvement, to quality work was emphasized in the training session referred to above.

**Matters That Did Not Result in a Qualified Report\***

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

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

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

Sincerely,

[Name of Firm]

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

**101. Appendix G  
Considerations Governing the Type of Report  
Issued on an Off-Site Peer Review**

**Circumstances Calling for a Qualified Report**

1. The objective of an off-site peer review is to provide the reviewer with a reasonable basis for expressing limited assurance that the financial statements or information and the related accountant's report on accounting and review engagements and attestation engagements submitted for review, conform in all material respects with the requirements of professional standards. Accordingly, when the review discloses significant departures from professional standards in the engagements reviewed, those departures should be clearly described in the peer review report as exceptions to the limited assurance expressed in the report. In this context, a significant departure from professional standards involves —
  - a. A departure from the measurement or disclosure requirements of generally accepted accounting principles or, if applicable, an other comprehensive basis of accounting, that can have a significant effect on the user's understanding of the financial information presented and that is not described in the accountant's report. Examples might include a failure to provide an allowance for doubtful accounts when it is probable that a material amount of accounts receivable is uncollectible; the use of an inappropriate method of revenue recognition; a failure to capitalize financing leases or to make important disclosures about significant leases; a failure to disclose significant related-party transactions; or a failure to disclose key assumptions in a financial forecast.
  - b. The issuance of a report on an accounting or review engagement that is misleading in the circumstances. Examples might include a review report on financial statements that omit substantially all of the disclosures required by generally accepted accounting principles; a compilation report on financial statements prepared on an other comprehensive basis of accounting that does not disclose the basis of accounting in the report or in a note to the financial statements.
  - c. The issuance of a report on an attestation engagement that is misleading in the circumstances. An example might include a review report that does not disclose the criteria against which the assertion was measured.
  - d. Other departures from professional standards, noted in a significant number of engagements submitted for review, that individually may not be considered a significant departure from professional standards but that collectively (or in the aggregate) would warrant the issuance of a qualified report. In

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reacting this decision, the reviewer should consider the significance and pervasiveness of the departures from professional standards.

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

### Circumstances Calling for an Adverse Report

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

### Other Departures That May Require Disclosure

4. The reviewer may note other departures from professional standards that are not deemed to be significant departures but that should be considered by the reviewed firm in evaluating the quality control policies and procedures over its accounting practice. The reviewer should describe these findings in the letter of comments (see appendix J).

## 102. Appendix H

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

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

August 31, 19XX

To the Owners  
Able, Baker & Co.

or

To John B. Able, CPA

We<sup>†</sup> have performed an off-site peer review with respect to the accounting practice of [Name of Firm] for the year ended June 30, 19XX, in accordance with standards established by the Peer Review Board of the American Institute of Certified Public Accountants (AICPA). [Name of Firm] has represented to us that the firm performed no services under the Statements on Auditing Standards or examinations of prospective financial statements under the Statements on Standards for Attestation Engagements during the year ended June 30, 19XX.

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

In connection with our off-site peer review, nothing came to our attention that caused us to believe that the reports submitted for review by [Name of Firm] for

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

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

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

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

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

John Brown, Reviewer\*  
[or Name of Reviewing Firm]

### 103. Appendix I Illustrations of Other Types of Reports on an Off-Site Peer Review

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

#### Qualified Report for Significant Departures From Professional Standards

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

As discussed in our letter of comments under this date, our review disclosed that the firm's review report on the financial statements of one of the engagements submitted for review did not disclose the failure to capitalize a financing lease, as required by generally accepted accounting principles. Also, significant financial statement disclosure deficiencies concerning related-party transactions were noted in several of the engagements reviewed.

[Concluding paragraph]

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

#### Adverse Report

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

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

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

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*[Adverse concluding paragraph]*

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

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

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

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

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

## **104. Appendix J Guidelines for and Illustration of a Letter of Comments on an Off-Site Peer Review**

### **Guidelines**

1. The objectives of the letter of comments on an off-site peer review are set forth in the Standards. Such letters are expected to be issued on many off-site reviews.
  - a. The letter should be addressed, dated, and signed in the same manner as the report on the off-site peer review, and should include the following:
    - a. A reference to the report on the review, indicating, where applicable, that the report was qualified or adverse
    - b. A description of the purpose of the off-site peer review
    - c. A statement that the review was performed in accordance with standards established by the Peer Review Board of the AICPA
    - d. A statement that the matters discussed in the letter were considered in preparing the report
    - e. The findings on the review and related recommendations (This section should be separated between those findings, if any, that resulted in a qualified or adverse report and those that did not. In addition, the letter should identify, where applicable, any comments that were also made in the letter of comments issued on the firm's previous peer review.)
2. In addition to matters that resulted in a qualified or adverse report, which must always be included in the letter, the letter of comments should include the following:
  - a. Other departures from professional standards that are not deemed to be significant departures but that should be considered by the reviewed firm in evaluating the quality control policies and procedures over its accounting practice
  - b. Instances in which the firm failed to comply with one or more of the membership requirements of the Private Companies Practice Section in all material respects, but the instances are not deemed to be significant enough to qualify the report

**Illustration of a Letter of Comments**

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

NO. 7085 P. 32

August 31, 19XX

To the Owners  
Able, Baker & Co.

or

To John B. Able, CPA

We have performed an off-site peer review with respect to the accounting practice of [Name of Firm] for the year ended June 30, 19XX, in accordance with standards established by the Peer Review Board of the American Institute of Certified Public Accountants (AICPA), and have issued our report thereon dated August 31, 19XX (which was qualified/adverse\* as described therein). This letter should be read in conjunction with that report.

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

**Matters That Resulted in a Qualified Report<sup>1</sup>**

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

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

<sup>1</sup> 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 review the reports issued during the last year and identify those reports that should have been modified to reflect a comprehensive basis of accounting other than generally accepted accounting principles. A memorandum should then be prepared highlighting the changes to be made in the current year and placed in the files of the client for whom a report must be changed.

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

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

3. **Finding** — During our review of the accountants' reports issued by the firm, we noted numerous instances in which the accompanying financial statements departed from professional standards and on which the accountants' reports were not appropriately qualified. These included the following:
  - Failure to disclose material intercompany transactions
  - Failure to appropriately recognize revenue
  - Failure to present financial statements in a proper format
  - Failure to recognize conflicting or incorrect information within the financial statements presented

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

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

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

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

**Matters That Did Not Result in a Qualified Report\***

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

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

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

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

(Same signature as on the report on the off-site peer review.)

\* 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.

**105. Appendix K****Illustration of a Response by a Reviewed Firm to a Letter of Comments on an Off-Site Peer Review**

The purpose of a letter of response is to describe the actions the firm has taken or will take to prevent a recurrence of each matter discussed in the letter of comments. If the reviewed firm disagrees with one or more of the findings or recommendations in the letter of comments, its response should describe the reasons for such disagreement. The letter of response should be carefully prepared because of the important bearing it may have on the decisions reached in connection with acceptance of the report on the review (see the section of these Standards on "Acceptance of Reviews"). If the firm has received a qualified or adverse report, the firm's responses should be separated between those findings that resulted in a qualified or adverse report and those that did not.

**Sample Letter of Response**

September 15, 19XX

(Addressed to the state CPA society administering the review.)

Ladies and Gentlemen:

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

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

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

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

Sincerely,

[Name of Firm]

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

**AICPA Peer Review Board (1995-1996)**

**JOHN R. BURZENSKI, *Chair***  
WILLIAM E. BALHOFF  
JOHN BELLITTO  
JOHN A. DEMETRIES  
WILLIAM J. DUFFNER  
B. BRADFORD FLOYD\*  
BRUCE W. HARTLEY  
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MELISSA R. NELSON\*  
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*Self Regulation & SECPS*

JANET LUALLEN  
*Senior Technical Manager*  
*Peer Review Program*

R. BRUCE BRASELL  
*Technical Manager*  
*Peer Review Program*

\* Consultant

**Peer Review Standards Interpretations  
(Issued Through January 1, 1997)**

## Peer Review Standards Interpretations (Issued Through January 1, 1997)

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

### Interpretation No. 1 — On-Site Peer Reviews of Sole Practitioners With Four or Fewer Professionals at a Location Other Than the Practitioner's Office

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

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

2. Interpretation: A review conducted at the reviewer's office or another agreed-upon location can achieve the objectives of an on-site peer review and can be described as such in the reviewer's report provided that (1) the reviewed firm is a sole practitioner with four or fewer professional staff; (2) the sole practitioner holds one or more meetings, by telephone or in person, with the reviewer to discuss the firm's responses to the quality control policies and procedures questionnaire, engagement findings, and the reviewer's conclusions on the review; (3) the sole practitioner did not receive a qualified or adverse report on his or her last committee-accepted on-site or off-site peer review; and (4) in addition to materials outlined in the "Instructions to Firms Having an On-Site Peer Review" (see *AICPA Peer Review Program Manual*, PRP section 4100.05), the sole practitioner sends the following materials to the reviewer prior to the review:

2. All documentation related to the resolution of independence questions (1) identified during the year under review with respect to any audit or accounting client or (2) related to any of the audit or accounting clients selected for review, no matter when the question was identified if the matter still exists during the review period

- h. The most recent independence confirmations received from other firms of CPAs engaged to perform segments of engagements on which the sole practitioner acted as principal auditor or accountant
  - c. The most recent representations received from all professional staff concerning their compliance with applicable independence requirements
  - d. Documentation, if any, of consultations with outside parties during the year under review in connection with audit or accounting services provided to any client
  - e. A list of relevant technical publications used as research materials, as referred to in question B.4 of the quality control policies and procedures questionnaire (see *AICPA Peer Review Program Manual*, PRP sections 4200.03.B.4 and 4300.03.C.7)
  - f. A list of audit and accounting materials, if any, identified in response to the questions in the "Engagement Performance" section of the quality control policies and procedures questionnaire (see *AICPA Peer Review Program Manual*, PRP section 4200.03.C)
  - g. Continuing Professional Education (CPE) records sufficient to demonstrate compliance by the CPAs in the firm with state and AICPA CPE requirements
  - h. The relevant working paper files and reports on the engagements selected for review
  - i. Any other evidential matter requested by the reviewer
  - j. Documentation of compliance with the membership requirements of the Private Companies Practice Section (if applicable)
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 and efficiency of this approach to the peer review.

### Interpretation No. 2 — Engagement Selection in On-Site Peer Reviews

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

5. Question: Paragraph 48 of the *Standards for Performing and Reporting on Peer Reviews* (*AICPA Peer Review Program Manual*, PRP section 3100.48), states: "The AICPA Peer Review Board may from time to time, by Interpretations, require that specific types of engagements be selected for review — for example, engagements required by a regulatory agency to be reviewed or those in particular areas in which public interest exists." On an on-site peer review, what specific type of engagements, if any, should be included in the sample of engagements selected for review or assessed at a higher level of peer review risk?

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

- a. Governmental — *Government Auditing Standards* (the Yellow Book), issued by the U.S. General Accounting Office, require auditors conducting audits in accordance with those standards to have a peer review that includes the review of at least one audit conducted in accordance with those standards. If a firm performs an audit of an entity subject to *Government Auditing Standards* and the peer review is intended to meet the requirements of those standards, at least one engagement conducted pursuant to those standards should be selected for review.
  - b. Depository Institutions — The 1993 Federal Deposit Insurance Corporation (FDIC) guidelines implementing the FDIC Improvement Act of 1991 (the Act) require auditors of federally insured depository institutions with more than \$500 million in total assets to have a peer review that includes the review of at least one audit of an insured depository institution subject to the Act. If a firm performs an audit of a federally insured depository institution subject to the Act and the peer review is intended to meet the requirements of the Act, at least one engagement conducted pursuant to the Act should be selected for review. The review of that engagement should include a review of the reports on internal control or compliance with laws and regulations, since those reports are required to be issued under the Act.
7. During the assessment of peer review risk on an on-site peer review, the following types of engagements should be assessed at a higher level of peer review risk:
- a. Employee Benefit Plans — Regulatory and legislative developments have made it clear that there is a significant public interest in and a higher risk associated with audits conducted pursuant to the Employee Retirement Income Security Act of 1974 (ERISA). Therefore, audits of entities subject to ERISA should be assessed at a higher level of peer review risk. If a firm performs the audit of one or more entities subject to ERISA and at least one such audit engagement is not selected for review, the review team should document its justification for why not in question (I.D.3) of the Summary Review Memorandum.
  - b. Securities and Exchange Commission (SEC) — Firms that audit one or more SEC clients as defined by Council in an Implementing Resolution under Bylaw Section 2.3.5 are required to enroll in the SEC Practice Section unless they have resigned, declined to stand for reelection, or been dismissed as auditor of all such clients. Only then can they enroll in the AICPA peer review program. Therefore, because there is a significant public interest in and a higher risk associated with audits of SEC registrants, such engagements should be assessed at a higher level of peer review risk. If a firm performs the audit of one or more SEC registrants during the year under review and at

least one such audit engagement is not selected for review, the review team should document its justification for why not in question (I.D.3) of the Summary Review Memorandum. In addition, the reviewer should satisfy himself or herself that the SEC has been notified by appropriate filings of Form 8-Ks that the firm has resigned, declined to stand for reelection, or been dismissed as auditor of the SEC clients that were clients at any time since the date of the firm's last peer review or during the year under review if the reviewed firm has not previously had a review.

### Interpretation No. 3 — Team Captain Training Course

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

8. Question: Paragraph 23 of the *Standards for Performing and Reporting on Peer Reviews* (AICPA Peer Review Program Manual, PRP section 3100.23) states that a team captain on an on-site peer review should "have completed a training course or courses that meet requirements established by the AICPA Peer Review Board" in order to qualify for service as a team captain. Paragraph 24 of the *Standards for Performing and Reporting on Peer Reviews* (AICPA Peer Review Program Manual, PRP section 3100.24) states that a reviewer on an off-site peer review should "have completed a training course or courses that meet requirements established by the AICPA Peer Review Board" in order to qualify for service as a reviewer. What specific type of course or courses, if any, should an on-site team captain and off-site reviewer complete?

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

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

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

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717-783-2664

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Joyce McKeever, Deputy Chief Counsel

TO :

IRRC/ATTN: Fiona W. Imartz & James Smith

DATE :

10/13/99

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TELEPHONE 717-787-8503

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