

1-1-2000

# SECPS reference manual : organization with membership requirements, standards for peer reviews, administrative, and other peer review procedures

Vincent M. Melita

Karen H. Jones

American Institute of Certified Public Accountants. SEC Practice Section

Follow this and additional works at: [https://egrove.olemiss.edu/aicpa\\_guides](https://egrove.olemiss.edu/aicpa_guides)

 Part of the [Accounting Commons](#), and the [Taxation Commons](#)

## Recommended Citation

Melita, Vincent M.; Jones, Karen H.; and American Institute of Certified Public Accountants. SEC Practice Section, "SECPS reference manual : organization with membership requirements, standards for peer reviews, administrative, and other peer review procedures" (2000). *Guides, Handbooks and Manuals*. 318.

[https://egrove.olemiss.edu/aicpa\\_guides/318](https://egrove.olemiss.edu/aicpa_guides/318)

This Article is brought to you for free and open access by the American Institute of Certified Public Accountants (AICPA) Historical Collection at eGrove. It has been accepted for inclusion in Guides, Handbooks and Manuals by an authorized administrator of eGrove. For more information, please contact [egrove@olemiss.edu](mailto:egrove@olemiss.edu).

# ***SEC PRACTICE SECTION REFERENCE MANUAL***

**ORGANIZATIONAL DOCUMENTS  
STANDARDS FOR PEER REVIEW  
ADMINISTRATION**



**Division for  
CPA Firms**  
AICPA

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Division for CPA Firms  
SEC Practice Section

**SEC PRACTICE SECTION REFERENCE MANUAL**

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

Prepared by  
Committees of the  
SEC Practice Section

Copyright © 1979, 1997, 1998, 2000 by  
American Institute of Certified Public Accountants, Inc.,  
New York, NY 10036-8775

All rights reserved. For information about permission to copy any part of this work for redistribution or for inclusion in another document or manuscript, please call the AICPA Copyright Permissions Hotline at 201-938-3245. A Permissions Request Form for emailing requests is available at [www.aicpa.org](http://www.aicpa.org) by clicking on the copyright notice on any page. Otherwise, requests should be mailed to the Permissions Department, AICPA, Harborside Financial Center, 201 Plaza Three, Jersey City, NJ 07311-3881.

First Edition 1979. Fourteenth Edition 2000

1234567890 PM 09876543210

## TABLE OF CONTENTS

<u>Section</u>		<u>Page</u>
<b>I</b>	<b>SEC Practice Section</b>	
SECPS 1000	Organizational Structure and Functions of the SEC Practice Section of the AICPA Division for CPA Firms	1001
<b>II</b>	<b>SECPS Peer Review Program Standards</b>	
SECPS 2000	Standards for Performing and Reporting on Peer Reviews	2001
2100	Guidelines for and Illustrations of Peer Review Reports	2101
2200	Guidelines for and Illustrations of the Letter of Comments	2201
2300	Suggestions for Writing a Response to a Letter of Comments	2301
2400	Standards for Performing and Reporting on Reviews of Quality Control Materials	2401
2500	Guidelines for Review of Continuing Professional Education Programs	2501
2600	Guidelines for Writing Letters on Monitoring Actions by Outside Parties	2601
<b>III</b>	<b>Associations</b>	
SECPS 3000	Guidelines for Involvement by Associations of CPA Firms	3001
<b>IV</b> 4000	(Deleted)	
<b>V</b>	<b>Administration</b>	
SECPS 5000	Administrative Procedures of the SECPS Peer Review Committee	5001
<b>VI</b>	<b>Peer Review Committee</b>	
SECPS 6000	SECPS Peer Review Committee Meeting and Voting Procedures	6001

## TABLE OF CONTENTS

<u>Section</u>		<u>Page</u>
VII	<b>Quality Control Inquiry Committee</b>	
SECPS 7000	Objectives, Organization, and Operations of the Quality Control Inquiry Committee	7001
VIII	<b>Continuing Professional Education</b>	
SECPS 8000	Continuing Professional Education Requirements	8001
IX	<b>Professional Issues Task Force</b>	
SECPS 9000	Objectives, Organization, and Operations of the Professional Issues Task Force	9001
	<b>Appendixes</b>	10,001
	A - Statement on Quality Control Standards 2 and 4, <u>System of Quality Control for a CPA Firm's Accounting and Auditing Practice</u>	
	B - Statement on Quality Control Standards 3, <u>Monitoring a CPA Firm's Accounting and Auditing Practice</u>	
	C - Statement on Quality Control Standards 5, <u>The Personnel Management Element of a Firm's System of Quality Control - Competencies Required by a Practitioner - in - Charge of an Attest Engagement</u>	
	D - <u>Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice</u>	

Section I

SEC PRACTICE SECTION OF THE AICPA DIVISION FOR CPA FIRMS

TABLE OF CONTENTS

Section

- 1000 Organizational Structure and Functions of the  
SEC Practice Section of the AICPA Division for  
CPA Firms

## SECPS Section 1000

**ORGANIZATIONAL STRUCTURE AND FUNCTIONS OF THE SEC PRACTICE  
SECTION OF THE AICPA DIVISION FOR CPA FIRMS**
**TABLE OF CONTENTS**

<u>Section</u>	<u>Paragraph</u>
1000 Organizational Structure and Functions of the SEC Practice Section of the AICPA Division for CPA Firms	
Source of Authority .....	.01
Name .....	.02
Objectives .....	.03
Membership .....	.04 - .08
Eligibility and Admission of Members .....	.04 - .05
Termination and Reinstatement of Members .....	.06 - .07
Requirements of Members .....	.08
Governing Bodies .....	.09
Executive Committee .....	.10 - .20
Composition and Terms .....	.10 - .12
Appointment .....	.13
Election of Chairman .....	.14
Responsibilities and Functions .....	.15
Quorum, Voting, Meetings, and Attendance .....	.16 - .20
Public Oversight Board .....	.21 - .23
Size, Appointment, Removal and Compensation ..	.21 - .22
Responsibilities and Functions .....	.23
Peer Reviews .....	.24 - .27
Review Requirements .....	.24
Peer Review Committee .....	.25 - .26
Composition and Appointment .....	.25
Responsibilities and Functions .....	.26
Peer Review Objectives .....	.27
Sanctions Against Firms .....	.28 - .29
Authority to Impose Sanctions .....	.28
Types of Sanctions .....	.29
Financing and Staffing of Section .....	.30 - .33
Section Staff and Meeting Costs .....	.30 - .31
Public Oversight Board and Special Projects .....	.32 - .33
Relationship to Other AICPA Segments .....	.34
Appendixes	
A-Executive Recruiting and Insurance Actuarial Services .....	.35



## Table of Contents

<u>Section</u>	<u>Paragraph</u>
1000	Appendixes (continued)
	B-Statement of Policy on the Imposition of Sanctions ..... .36
	C-Timing of Peer Reviews ..... .37
	D-Definition of an SEC Engagement ..... .38
	E-Scope of the Concurring Review Requirement ..... .39
	F-Resolution Regarding Failures to Meet Certain Membership Requirements ..... .40
	G-Statement of Policy on the Peer Review Program ..... .41
	H-Illustrative Statement of Firm Philosophy .. .42
	I-Standard Form of Letter Confirming the Cessation of the Client-Auditor Relationship ..... .43
	J-SEC Practice Section Dues ..... .44
	K-SECPS Member Firms With Foreign-Associated Firms That Audit SEC Registrants ..... .45
	L-Independence Quality Controls ..... .46

## Organizational Structure and Functions of the SEC Practice Section

### SOURCE OF AUTHORITY

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

### NAME

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

### OBJECTIVES

- .03 The objectives of the Section shall be to achieve the following:
- a. Improve the quality of practice by CPA firms before the Securities and Exchange Commission through the establishment of practice requirements for member firms.
  - b. Establish and maintain an effective system of self-regulation of member firms by means of mandatory peer reviews, required maintenance of appropriate quality controls, and the imposition of sanctions for failure to meet membership requirements.
  - c. Enhance the effectiveness of the Section's regulatory system through the monitoring and evaluation activities of an independent oversight board composed of public members.
  - d. Provide a forum for development of technical information relating to SEC practice.

### MEMBERSHIP

#### Eligibility and Admission of Members

- .04 All CPA firms are eligible for membership in the Section even though they do not practice before the SEC. Membership in the Section shall not constitute membership in the AICPA nor entitle any member firm to any of the rights or privileges of membership in the AICPA. To become a member, a firm must submit to the Section a written application agreeing to abide by all of the requirements for membership. The application must be accompanied by firm information for the most recent full fiscal year as described under SECPS §1000.08g.

**1004 Organizational Structure and Functions of the SEC Practice Section**

- .05 The membership of the Section shall consist of all firms which meet with the admission requirements and continue to maintain their membership in good standing.

**Termination and Reinstatement of Members**

- .06 Membership of a CPA firm may be terminated--
- a. By submission of a resignation, provided the firm is not the subject of a pending investigation or recommendation of the Peer Review Committee for sanctions (see Appendix B, SECPS §1000.36) or other disciplinary action by the Executive Committee or under review by the Public Oversight Board.
  - b. By action of the Executive Committee for failure to adhere to the requirements of membership. (See Appendix F, SECPS §1000.40 and Appendix G, SECPS §1000.41.)
- .07 Membership of a terminated CPA firm may be reinstated--
- a. By complying with the admission requirements for new members if termination occurred by resignation. (See Appendix C, SECPS §1000.37.)
  - b. By complying with the admission requirements for new members and obtaining the approval of the Executive Committee if termination was imposed as a sanction.

**Requirements of Members**

- .08 Member firms shall be obligated to abide by the following:
- a. Ensure that each member of the firm (that is, proprietors, shareholders, or partners) residing in the United States and eligible for AICPA membership is a member of the AICPA.
  - b. Adhere to quality control standards established by the AICPA.
  - c. Submit to and pay for peer reviews of the firm's accounting and auditing practice every three years or at such additional times as designated by the Executive Committee, the reviews to be conducted in accordance with review standards established by the Section's Peer Review Committee. (See Appendix C, SECPS §1000.37 and Appendix G, SECPS §1000.41.)

**Organizational Structure and Functions of the SEC Practice 1005  
Section**

- d. Ensure that all professionals in the firm residing in the United States, including CPAs and non-CPAs, participate in at least 20 hours of qualifying continuing professional education (CPE) every year and at least 120 hours every three years. Effective for CPE years beginning on or after January 1, 1995, professionals who devote at least 25% of their time to performing audit, review or other attest engagements (excluding compilations), or who have the partner/manager-level responsibility for the overall supervision or review of any such engagements, must obtain at least 40% (eight hours in any one year and 48 hours every three years) of their required CPE in subjects relating to accounting and auditing. The term *accounting and auditing subjects* should be broadly interpreted, and for example, include subjects relating to the business or economic environments of the entities to which the professional is assigned.<sup>1</sup>
- e. Assign an audit partner<sup>2</sup> to be in charge of each SEC engagement<sup>3</sup>. Upon application for relief, **PRIOR** to assigning a non-partner level individual to be in charge of an SEC engagement, the Peer Review Committee may authorize alternative procedures where this requirement cannot be met because of the size or structure of the firm<sup>4</sup>.

Assign a new audit partner<sup>2</sup> to be in charge of each SEC engagement that has had another audit partner-in-charge for a period of seven consecutive years,<sup>3</sup> and prohibit such incumbent partner from returning to in-charge status

---

<sup>1</sup> See SECPS §8000 for additional information about the continuing professional education requirement and the manner in which compliance is to be measured.

<sup>2</sup> As used in this section, **partner** refers to an individual who is legally a partner, owner or shareholder in a CPA firm or a sole practitioner. Such individuals should be party to any partnership, ownership or shareholder agreement of a CPA firm.

<sup>3</sup> See Appendix D, SECPS §1000.38, "Definition of an SEC Engagement," for purposes of determining compliance with the membership requirements of SECPS §1000.08e, f, g, h, i, k, l and o.

<sup>4</sup> See Appendix G, SECPS §2000.148, "Interpretation: Alternative Partner Assignment Arrangements. "

**1006 Organizational Structure and Functions of the SEC Practice Section**

on the engagement for a minimum of two years except as follows:<sup>5</sup>

- (1) This requirement does not apply to member firms that meet both the following criteria:
    - (a) less than five SEC clients, and
    - (b) less than ten partners
  - (2) An audit partner who has been the audit partner-in-charge of an SEC audit client for seven consecutive years may continue to serve in that capacity for audits for periods ending within two years from the date the firm becomes a member, or within two years from the date the firm no longer qualifies for the exemption in (1) above, whichever is later.
  - (3) An application for relief is granted by the Peer Review Committee on the basis of unusual circumstances.
- f. Establish policies and procedures that meet the requirements set forth in Appendix E, SECPS §1000.39, for a concurring review by a partner other than the audit partner in charge of an SEC engagement before issuance of an audit report on the financial statements of an SEC engagement and before the reissuance of such an audit report where the performance of subsequent events procedures is required by professional standards.<sup>6</sup> The SECPS Peer Review Committee may authorize alternative procedures where this requirement cannot be met because of the size of the member firm.
- g. File with the Section for each fiscal year of the United States firm (covering offices maintained in the United

---

<sup>5</sup> When an existing audit engagement becomes an SEC engagement, time served as audit partner-in-charge of the engagement before it became an SEC engagement is to be considered in applying the seven-year partner rotation requirement. However, the incumbent partner may serve as audit partner-in-charge of the engagement for two consecutive annual examinations subsequent to the date that the engagement became an SEC engagement.

<sup>6</sup> Effective for audits of financial statements of SEC clients for periods ending after the date the firm becomes a member and for reports that are reissued after that date.

**Organizational Structure and Functions of the SEC Practice 1007  
Section**

States and its territories) the following information, within ninety days of the end of such fiscal year, to be open to public inspection:

- (1) Form of business entity (for example, partnership or corporation)
- (2) Name of (a) managing partner or equivalent and (b) person to contact at the firm concerning SECPS membership and other matters
- (3) Number and location of offices
- (4) Month in which the firm's (a) fiscal year ends, and (b) "educational year" ends<sup>7</sup>
- (5) Total number of (a) partners and non-CPAs with parallel status, and (b) partners that are CPAs
- (6) Total number of CPAs (including partners)
- (7) Total number of professional staff (including partners)
- (8) Total number of personnel (including item 5, above)
- (9) Disclosure regarding pending litigation as required under generally accepted accounting principles and indicating whether such pending litigation is expected to have a material effect on the firm's financial condition or its ability to serve clients
- (10) Number of SEC clients for which the firm is principal auditor-of-record; for this purpose, series of unit investment trusts and series of limited partnerships sponsored by the same entity shall be treated as one SEC client
- (11) A statement indicating that the firm has complied with AICPA, ISB and SEC independence requirements

---

<sup>7</sup> The annual report should disclose the member firm's educational year, if different from its fiscal year, and any change in the educational year. (See SECPS §8000.03.)

**1008 Organizational Structure and Functions of the SEC Practice Section**

- (12) Gross fees for accounting and auditing, tax, MAS from SEC audit clients, and MAS from all other clients, expressed as a percentage of total gross fees
- (13) Gross fees for MAS, tax, and accounting and auditing services performed for SEC audit clients, expressed as a percentage of total fees charged to all SEC audit clients, and the number of clients that receive each such type of service
- (14) Fees for MAS services performed for SEC audit clients, expressed as a percentage of audit fees charged to such SEC clients, prepared in the following manner:

<u>Range of MAS Fees to Audit Fees for SEC Audit Clients</u>	<u>Number of SEC Audit Clients</u>
0%	
1-25%	
26-50%	
51-100%	
Over 100%	_____
Total number of SEC audit clients	_____

- (15) The total number of SEC audit clients reported in this summary shall agree with the number reported pursuant to the requirements of SECPS §1000.08g.(9). The firm shall also report how many of the number of SEC audit clients included in the "over 100 percent" category fell into that category for three consecutive years, including the current year.
- (16) Representing that the firm has made the necessary reports to the Quality Control Inquiry Committee regarding any litigation or publicly announced regulatory proceedings or investigations against the firm or its personnel relating to SEC audit clients.
- (17) Names of firms merged or acquired during the year and included in year-end numbers reported above and the number of offices, accounting and auditing personnel, and SEC clients of the acquired firm that were-

Organizational Structure and Functions of the SEC Practice 1009  
Section

- (i) Combined with practice units of the acquiring firm, or
  - (ii) Continued as separate practice units in the combined firm.
- (18) The name and country of the foreign associated firms, if any, for which the SECPS member firm has been advised by written representation from its international organization or individual foreign associated firms that policies and procedures that are consistent with the objectives set forth in Appendix K, SECPS §1000.45 have been established pursuant to SECPS §1000.08(n).
- h. Adhere to the portions of the AICPA Code of Professional Conduct and the Statement on Standards for Consulting Services dealing with independence in performing management advisory services for SEC audit clients. Refrain from performing for such clients services that are inconsistent with the firm's responsibilities to the public or that consist of the following types of services:
- (1) Psychological testing
  - (2) Public opinion polls
  - (3) Merger and acquisition assistance for a finder's fee
  - (4) Executive recruitment as described in Appendix A, SECPS §1000.35
  - (5) Actuarial services to insurance companies as described in Appendix A, SECPS §1000.35
- i. Report annually to the audit committee or board of directors (or its equivalent in a partnership) of each SEC audit client on the total fees received from the client for management advisory services during the year under audit and a description of the types of such services rendered.<sup>8</sup>
- j. Pay dues as established by the Executive Committee (see Appendix J, SECPS §1000.44) and comply with the rules and

---

<sup>8</sup> Effective for audits of financial statements of SEC clients for periods ending after the date the firm becomes a member.



1010 **Organizational Structure and Functions of the SEC Practice Section**

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; in connection with their duties, including disciplinary proceedings, cooperate with the Peer Review Committee and the Quality Control Inquiry Committee established by resolution of the Executive Committee;<sup>9</sup> and comply with any sanction that may be imposed by the Executive Committee (see Appendix B, SECPS §1000.36).

- k. Report to the Quality Control Inquiry Committee (QCIC) any litigation (including criminal indictments) against the firm or its personnel or any proceeding or investigation publicly announced by a regulatory agency that alleges deficiencies in the conduct of an audit of the financial statements or reporting thereon of a present or former SEC client.<sup>10</sup> Such reports shall also include any allegations made in such formal litigation, proceeding, or investigation that a member firm or its personnel have violated the federal securities laws in connection with services other than audit services. All reports of litigation, proceedings or investigations to the QCIC shall be made within thirty days of service on the firm or its personnel of the first pleading in the matter. With respect to matters previously reported pursuant to this membership requirement, member firms shall report to the committee additional litigation, proceedings or investigations within thirty days of their occurrence.
- l. Communicate through a written statement to all professional firm personnel the broad principles that influence the firm's quality control and operating policies and procedures on, as a minimum, matters related to the recommendation and approval of accounting principles, present and potential client relationships, and the types of services provided, and inform professional firm personnel periodically that compliance

---

<sup>9</sup> See SECPS §7000 for a description of the objectives, organization, and operations of the Quality Control Inquiry Committee.

<sup>10</sup> New member firms shall report within thirty days of joining the Section such litigation, proceedings or investigations, as defined, as may have been filed or announced within the three-year period preceding the firm's admission to the Section.

**Organizational Structure and Functions of the SEC Practice 1011  
Section**

with those principles is mandatory.<sup>11</sup> (Appendix H, SECPS §1000.42 is an illustration of such a statement.)

- m. When the member firm has been the auditor for an SEC registrant (as defined in Appendix D, SECPS §1000.38) and has resigned, declined to stand for re-election or been dismissed, report the fact that the client-auditor relationship has ceased directly in writing to the former SEC client, with a simultaneous copy to the Office of the Chief Accountant of the Securities and Exchange Commission.<sup>12</sup> Such report shall be sent to the former SEC client and to the Office of the Chief Accountant by the end of the fifth business day following the member firm's determination that the client-auditor relationship has ended, irrespective of whether or not the registrant has reported the change in auditors in a timely filed Form 8-K.
- n. For SECPS member firms that are members of, correspondents with, or similarly associated with international firms or international associations of firms, (1) seek adoption of policies and procedures by the international organization or individual foreign associated firms<sup>13</sup> that are consistent with the objectives set forth in Appendix K, SECPS §1000.45 for SEC registrants<sup>14</sup> and (2) report annually, pursuant to SECPS §1000.08(g) (3), the name and country of the foreign associated firms, if any, for which the SECPS member firm has been advised by written representation from its international organization or the individual foreign associated firms that such policies and procedures have been established.

---

<sup>11</sup> Firms that become members of the Section shall prepare and issue such a statement within six months of joining the Section.

<sup>12</sup> See Appendix I, SECPS §1000.43, for standard form of such report.

<sup>13</sup> For this purpose, a foreign associated firm is a firm domiciled outside of the United States and its territories that is a member of, correspondent with, or similarly associated with an international firm or international association of firms with which the SECPS member is associated.

<sup>14</sup> See Appendix D, SECPS §1000.38, "Definition of an SEC Engagement" for purposes of determining compliance with the membership requirements of SECPS §1000.08e, f, g, h, i, k, m, n and o.

**1012 Organizational Structure and Functions of the SEC Practice Section**

- o. Ensure that the member firm has policies and procedures in place to comply with independence requirements of the AICPA, SEC and Independence Standards Board. Each member firm will establish independence policies covering relationships between (a) the member firm, its benefit plans, and its professionals and (b) restricted entities of the firm.<sup>15</sup>

**GOVERNING BODIES**

- .09 The activities of the section shall be governed by an executive committee having senior status within the AICPA with authority to carry out the activities of the section. Such activities shall not conflict with the policies and standards of the AICPA. All activities of the Section shall be subject to oversight and public reporting thereon by a Public Oversight Board.

**EXECUTIVE COMMITTEE**

**Composition and Terms**

- .10 The Executive Committee shall be composed of representatives of at least 14 member firms.
- .11 The terms of Executive Committee members shall be for three years, and shall be eligible for reappointment for additional one-year terms.
- .12 Executive Committee members shall continue in office until their successors have been appointed.

**Appointment**

- .13 Members of the Executive Committee shall be appointed by the chairman of the AICPA Board of Directors with the approval of the board and the concurrence of the Executive Committee. Appointments shall give appropriate recognition to the focus of the Section on practice before the Securities and Exchange Commission.

---

<sup>15</sup> See Appendix L, SECPS §1000.46 "Independence Quality Controls" for purposes of determining compliance with the membership requirement.

**Organizational Structure and Functions of the SEC Practice Section 1013**

**Election of Chairman**

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

**Responsibilities and Functions**

- .15 The Executive Committee shall-
- a. Establish general policies for the Section and oversee its activities.
  - b. Amend requirements for membership as necessary, but in no event shall such requirements be designed so as to unreasonably preclude membership by any CPA firm.
  - c. Establish budgets and dues requirements to fund activities of the Section not provided for in the AICPA general budget. Such dues shall be scaled in proportion to the size of member firms.
  - d. Determine sanctions to be imposed on member firms for failure to comply with the Section's membership requirements, ordinarily through the appointment of hearing and appeals panels.
  - e. Receive, evaluate, and act upon other complaints received with respect to actions of member firms.
  - f. Establish the initial Public Oversight Board with the approval of the AICPA Board of Directors.
  - g. Appoint persons to serve on such committees and task forces as necessary to carry out its functions.
  - h. Make recommendations to other AICPA boards and committees for their consideration.
  - i. Consult from time to time with the Public Oversight Board.

**Quorum, Voting, Meetings, and Attendance**

- .16 A majority of the members of the Executive Committee or their designated alternates must be present to constitute a quorum.

**1014 Organizational Structure and Functions of the SEC Practice Section**

- .17 Affirmative votes of a majority of the members of the Executive Committee shall be required for action on all matters.
- .18 Meetings of the Executive Committee shall be held at such times and places as determined by the chairman.
- .19 Representatives of member firms of the Section may attend meetings of the Executive Committee as observers under rules established by the Executive Committee. Such attendance will not be permitted when the Executive Committee is considering disciplinary matters.
- .20 Determinations of hearing and appeals panels with respect to the imposition of sanctions on member firms will be decided by majority vote of the members of such panels, in accordance with the Rules of Procedure established for such proceedings.

**PUBLIC OVERSIGHT BOARD**

**Size, Appointment, Removal and Compensation**

- .21 The Public Oversight Board shall consist of five members. Members of such board shall be drawn from among prominent individuals of high integrity and reputation, including, but not limited to, former public officials, lawyers, bankers, securities industry executives, educators, economists, and business executives.
- .22 The Public Oversight Board shall appoint, remove, and set the terms and compensation of its members and select its chairman. However, such board shall automatically terminate in the event of the termination of the SEC Practice Section of the AICPA Division for CPA Firms.

**Responsibilities and Functions**

- .23 The Public Oversight Board shall-
  - a. Monitor and evaluate the activities of the Peer Review and Executive Committees to assure their effectiveness.
  - b. Determine that the Peer Review Committee is ascertaining that firms are taking appropriate action as a result of peer reviews.
  - c. Conduct continuing oversight of all other activities of the Section.

**Organizational Structure and Functions of the SEC Practice Section 1015**

- d. Make recommendations to the Executive Committee for improvements in the operations of the Section.
- e. Publish an annual report and such other reports as may be deemed necessary with respect to its activities.
- f. Engage staff to assist in carrying out its functions.
- g. Have the right for any or all of its members to attend any meetings of the Executive Committee.

**PEER REVIEWS**

**Review Requirements**

- .24 Peer reviews of member firms shall be conducted every three years or at such additional times as designated by the Executive Committee. (See Appendix C, SECPS §1000.37.)

**Peer Review Committee**

**Composition and Appointment**

- .25 The Peer Review Committee shall be a continuing committee appointed by the Executive Committee and shall consist of not less than 15 individuals selected from member firms.

**Responsibilities and Functions**

- .26 The Peer Review Committee shall-
- a. Administer the program of peer reviews for member firms.
  - b. Establish standards for conducting reviews.
  - c. Establish standards for reports on peer reviews and publication of such reports.
  - d. Request the chairman of the Executive Committee to appoint a hearing panel when it is believed sanctions should be imposed on a member firm for failure to comply with membership requirements.
  - e. Consult from time to time with the Public Oversight Board.
  - f. Keep appropriate records of peer reviews that have been conducted.

1016 Organizational Structure and Functions of the SEC Practice Section

Peer Review Objectives

- .27 The objectives of peer reviews shall be to determine that-
- a. Member firms, as distinguished from individuals, are maintaining and applying quality controls in accordance with standards established by the AICPA. Reviews for this purpose shall include a review of working papers rather than specific "cases." (The existence of "cases" in a firm might raise questions concerning its quality controls.)
  - b. By reviewing the procedures of member firms, appropriate steps are being taken to gain proper assurance about the quality of work done on those portions of audits performed in other countries.
  - c. Member firms are meeting membership requirements.

SANCTIONS AGAINST FIRMS

Authority to Impose Sanctions

- .28 The Executive Committee shall have the authority to impose sanctions on member firms. Ordinarily such sanctions shall be determined by hearing and appeals panels operating under Rules of Procedure designed to assure due process to firms subject to such proceedings. (See Appendix B, SECPS §1000.36.)

Types of Sanctions

- .29 The following types of sanctions may be imposed on member firms for failure to maintain compliance with the requirements for membership:
- a. Require corrective measures by the firm, including consideration by the firm of appropriate actions with respect to individual firm personnel
  - b. Additional requirements for continuing professional education
  - c. Accelerated or special peer reviews
  - d. Admonishments, censures, or reprimands
  - e. Monetary fines

**Organizational Structure and Functions of the SEC Practice Section 1017**

- f. Suspension from membership
- g. Expulsion from membership

**FINANCING AND STAFFING OF SECTION**

**Section Staff and Meeting Costs**

- .30 The president of the AICPA shall appoint a staff director and assign such other staff as may be required by the Section.
- .31 The cost of the Section staff and normal meeting costs shall be paid out of the general budget of the AICPA.

**Public Oversight Board and Special Projects**

- .32 The costs of the Public Oversight Board and its staff shall be paid out of the dues of the Section.
- .33 The cost of special projects shall be paid out of the dues of the Section.

**RELATIONSHIP TO OTHER AICPA SEGMENTS**

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



1018 Organizational Structure and Functions of the SEC Practice Section

.35 APPENDIX A - Executive Recruiting and Insurance Actuarial Services

Executive Recruiting Services

1. The hiring of persons for managerial, executive, or director positions is a function that is properly the client's responsibility. Accordingly, the member firm's role in this function should be limited. In serving an audit client as defined in Appendix D, SECPS §1000.38, (including subsidiaries and affiliates of such clients), a member firm should not-
  - a. Accept an engagement to search for, or seek out, prospective candidates for managerial, executive, or director positions with its audit clients. This would not preclude giving the name of a prospective candidate known to someone in the member firm, provided such knowledge was not obtained as a result of the performance of executive recruiting services for another client.
  - b. Engage in psychological testing, other formal testing or evaluation programs, or undertake reference checks of prospective candidates for an executive or director position.
  - c. Act as a negotiator on the client's behalf; for example, in determining position, status or title, compensation, fringe benefits, or other conditions of employment.
  - d. Recommend, or advise the client to hire, a specific candidate for a specific job. However, a member firm may, upon request by the client, interview candidates and advise the client on the candidate's competence for financial, accounting, administrative, or control positions.
2. When a client seeks to fill a position within its organization that is related to its system of accounting, financial, or administrative controls, the client will frequently approach employees of the member firm directly as candidates or seek referral of the member firm's employees who may be considering employment outside of the profession. Such employment from time to time is an inevitable consequence of the training and experience that the public accounting profession provides to its staff, is beneficial to all concerned, including society in general, and therefore is not proscribed.

Insurance Actuarial Services

3. Actuarial skills are both accounting and auditing related. The bodies of knowledge supporting the actuarial and accounting professions have a substantial degree of overlap. Both professions involve the analysis of various factors of time, probability, and economics and the quantification of such analysis in financial terms. The results of their work are significantly interrelated. The professions are logical extensions of each other; indeed, they have been practiced jointly for many years and even shared the same professional society in Scotland prior to their becoming established in the United States.
4. The work of actuarial specialists generally is necessary to obtain audit satisfaction in support of insurance policy and loss reserves. To assist them in meeting their audit responsibilities, a number of CPA firms have hired qualified actuaries of their own.
5. The actuarial function is basic to the operation and management of an insurance company. Management's responsibility for this function cannot be assumed by the CPA firm without jeopardizing the CPA firm's independence. Because of the special significance of a CPA firm's appearance of independence when auditing publicly held insurance companies-
  - a. The CPA firm should not render actuarially oriented advisory services involving the determination of policy reserves and related accounts to its audit clients unless such clients use their own actuaries or third-party actuaries to provide management with the primary actuarial capabilities. This does not preclude the use of the CPA firm's actuarial staff in connection with the auditing of such reserves.
  - b. Whenever the CPA firm renders actuarially oriented advisory services, it must satisfy itself that it is acting in an advisory capacity and that the responsibility for any significant actuarial methods and assumptions is accepted by the client.
  - c. The CPA firm should not render actuarially oriented advisory services when the CPA firm's involvement is continuous because such a relationship might be perceived as an engagement to perform a management function.

**1020 Organizational Structure and Functions of the SEC Practice Section**

6. Subject to the above limitations, it is appropriate for the CPA firm to render certain actuarially oriented advisory services to its audit clients. Such services include-
  - a. Assisting management to develop appropriate methods, assumptions, and amounts for policy and loss reserves and other actuarial items presented in financial reports based on the company's historical experience, current practice, and future plans.
  - b. Assisting management in the conversion of financial statements from a statutory basis to one conforming with generally accepted accounting principles.
  - c. Analyzing actuarial considerations and alternatives in federal income tax planning.
  - d. Assisting management in the financial analyses of various matters such as proposed new policies, new markets, business acquisitions, and reinsurance needs.

**Organizational Structure and Functions of the SEC Practice 1021  
Section**

**.36 APPENDIX B—Statement of Policy on the Imposition of Sanctions**

1. This statement of policy outlines the circumstances in which the Executive Committee, either on its own initiative or on the basis of recommendations of the Peer Review Committee or the Quality Control Inquiry Committee, would consider whether to impose sanctions publicly on member firms for "failure to maintain compliance with the requirements for membership" pursuant to SECPS §1000.28-.29 of this section. Member firms and, more particularly, firms considering membership in the Section have raised questions on this broad matter. This statement of policy responds to those questions. It does not change present practices.

**Present Practices**

2. Member firms are required, among other things, to establish an adequate system of quality control for their accounting and auditing practice, if they have not already done so. The adequacy of that system and compliance by the firm with the system and with the other membership requirements of the Section are tested in the peer review process and in certain circumstances may be further tested through procedures followed by the Quality Control Inquiry Committee. Member firms are required to cooperate with the Peer Review Committee and with the Quality Control Inquiry Committee, which includes taking corrective actions deemed necessary by those committees. Such corrective actions have included and will continue to include the following actions, which could be imposed as sanctions pursuant to SECPS §1000.28-.29 of the organizational structure and functions document:
  - a. Requiring corrective measures by the firm, including consideration by the firm of appropriate actions with respect to individual firm personnel
  - b. Additional requirements for continuing professional education
  - c. Accelerated or special peer review
3. When firms agree to take such actions, no hearings are necessary under the Section's due process procedures and no public announcement is made of the actions agreed to by the firm. (The firm's public file will, however, disclose any conditions agreed to in connection with acceptance by the Peer Review Committee of a peer review report.) If a firm believes that the corrective actions deemed necessary by the Peer

**1022 Organizational Structure and Functions of the SEC Practice Section**

Review or Quality Control Inquiry Committees are unreasonable, the Section's due process procedures are available.

**Concepts Underlying Present Practices**

4. The primary objective of the Section is to improve quality, a future-oriented objective best achieved through the voluntary cooperation of member firms in undertaking corrective action when deficiencies are found. The formal and public application of sanctions, as well as public disclosure of matters related to pending litigation, may in fact inhibit such improvement. For example, the most significant sanction available to the Section is expulsion from membership, which would remove the firm from any further review or oversight.
5. Firms are held accountable for specific infractions that are judged to have caused harm to the public by the courts and regulatory agencies which, having the power to subpoena documents and compel testimony from all involved parties (not just the CPA firm), are in the best position to determine the facts, observing due process to protect the rights of the parties, to determine blame, and to assess penalties. The imposition of sanctions by the Section on a firm involved in pending litigation or in a proceeding or investigation by a regulatory agency that has not been concluded would result in substantial prejudice to the firm or its personnel and would abrogate certain of the rights of the firm and its personnel in defending themselves in such litigation, proceeding or investigation. Any sanctions publicly imposed by the Section after the courts or regulatory agencies have concluded their activity would generally be an unnecessary duplication made long after a useful purpose might be served.

**Circumstances in Which the Public Imposition of Sanctions Would Be Considered**

6. The Executive Committee will consider whether to impose sanctions publicly on a member firm only in the following circumstances:
  - a. When a firm refuses to comply with a decision of the Executive Committee or to cooperate—which includes taking necessary corrective actions—with the Peer Review Committee or the Quality Control Inquiry Committee in connection with their duties. Those duties, and the obligations of member firms, are described in the documents entitled "Standards for Performing and Reporting on Peer Reviews" (SECPS §2000) and "Objectives,

**Organizational Structure and Functions of the SEC Practice Section 1023**

Organization, and Operations of the Quality Control Inquiry Committee" (SECPS §7000.)

- b. When the results of a peer review or an investigation by the Quality Control Inquiry Committee reveal failures to comply with the Section's membership requirements for which corrective action would be an inadequate response. Such a determination involves both qualitative and quantitative judgments. The fact that a member firm received an adverse report on its peer review or the fact that an investigation by the Quality Control Inquiry Committee identified one or more significant deficiencies in a firm's system of quality control or compliance therewith should not, in and of itself, cause those committees to recommend that sanctions be publicly imposed on the firm.

7. Some critics have asserted that the public imposition of sanctions is necessary to achieve credibility for the Section and its programs. The Executive Committee believes that view is based on a misperception of the objectives of the Section and that it fails to consider the role of the courts, regulatory agencies, standards setters and others in assuring the integrity of the financial reporting process. The SEC practice section is an important part, but only a part, of that overall effort. Indeed, the effectiveness of the Section is demonstrated by the fact that, with the cooperation of its member firms, it has secured and will continue to secure improvements in the quality of practice without the need to resort to public sanctions.

1024 Organizational Structure and Functions of the SEC Practice Section

.37 APPENDIX C - Timing of Peer Reviews

1. The Executive Committee has determined that a member firm must have its initial peer review completed within one year from the date the firm joins the Section except as indicated below:
  - a. If the firm was enrolled in the AICPA Peer Review Program prior to joining the SECPS and did not have a review under that program ("the previous program"), its initial SECPS peer review must begin by the date set under the previous program or ninety days after joining SECPS, whichever is later.
  - b. If a firm is joining the Section as a result of an agreement with the Securities and Exchange Commission or another governmental regulatory body involving the firm or its personnel, a condition of acceptance will be that the peer review field work will be scheduled to start within ninety days of the firm's acceptance into the Section.
  - c. If the firm has undergone a peer review under the auspices of the AICPA Peer Review Program, it may defer its SEC Practice Section peer review until three years from the date of such review provided that the following conditions are met: (1) the report and letter of comments issued in connection with such review and the firm's response thereto are included in the firm's public file, and (2) any voluntary action agreed to pursuant to the operative Committee's consideration of that review is satisfactorily completed. This type of deferral will be granted only once to the firm.
2. A member firm's subsequent peer reviews must be completed by the end of the third calendar year following the calendar year that included the previous year-end. Although it is expected that a firm ordinarily will not change its review year-end, a firm may do so without the Peer Review Committee's prior approval, provided that the new review year-end is not beyond three months of the previous review year-end and provided that the peer review is completed in accordance with the requirement in the preceding sentence.

(Approved by the Executive Committee December 4, 1991)

.38 APPENDIX D - Definition of an SEC Engagement

Definitions

1. For purposes of determining the number of SEC clients for which a firm is the principal auditor-of-record, information is required to be filed with the Section for each fiscal year of a U.S. member firm [see SECPS §1000.08g.(10), (13), (14), and (15)]. The Executive Committee has defined an SEC client as one that involves the examination of the financial statements of the following:
  - a. An issuer making an initial filing, including amendments, under the Securities Act of 1933.
  - b. A registrant that files periodic reports (for example, Forms N-SAR and 10-K) with the Securities and Exchange Commission (SEC) under the Investment Company Act of 1940 or the Securities Exchange Act of 1934 (except a broker or dealer registered only because of section 15(a) of that Act).
  - c. An employee stock purchase, savings or similar plan that files a Form 11-K with the Securities and Exchange Commission (SEC) pursuant to Section 15(d) of the Securities Exchange Act of 1934.
2. For purposes of implementing the membership requirements of SECPS §1000.08e, f, h, i, k, n and o, the Executive Committee has determined that the term SEC client (which is used interchangeably with SEC audit client, SEC registrant, and SEC engagement) shall also encompass the following:
  - a. A bank or other lending institution that files periodic reports with the Comptroller of the Currency, the Federal Reserve System, the Federal Deposit Insurance Corporation, or the Office of Thrift Supervision, because the powers, functions, and duties of the SEC to enforce its periodic reporting provisions are vested, pursuant to section 12(i) of that act, in those agencies.

[Rules 12g-4 and 12h-3 under the Exchange Act provide an exemption from periodic reporting to the SEC to (1) entities with less than \$10 million in total assets on the last day of the issuer's three most recent fiscal years and less than 500 shareholders and (2) entities with less than 300 shareholders. Accordingly, such entities are not encompassed within the scope of this definition.]



**1026 Organizational Structure and Functions of the SEC Practice Section**

- b. A company whose financial statements appear in the annual report or proxy statement of an investment fund because it is a sponsor or manager of such a fund, but which is not itself a registrant required to file periodic reports under the 1940 act or section 13 or 15(d) of the 1934 act.
3. In addition, for purposes of implementing the requirement of SECPS §1000.08k to report certain litigation, proceedings, or investigations to the Quality Control Inquiry Committee, the Executive Committee has determined that the term SEC client shall include a subsidiary or investee of an entity encompassed by paragraph 1 above, if such matters relate to financial statements presented separately in parent or investor company filings under the 1934 act.
4. For purposes of implementing the membership requirements of SECPS §1000.08(n), the Executive Committee has determined that the term SEC registrant shall also encompass all foreign private issuers defined by Rule 405 of Regulation C under the Securities Act of 1933 and Rule 3b-4(c) under the Securities Exchange Act of 1934 that have securities registered or have filed a registration statement with the SEC.
5. None of the foregoing is intended to change SECPS §1000.13 of the organizational structure and functions section regarding the appointment of members to the Executive Committee of the Section.

**Organizational Structure and Functions of the SEC Practice 1027  
Section**

**.39 APPENDIX E - Concurring Partner Review Requirement (Revised  
with an Effective Date of October 1, 1999)**

Statement on Auditing Standards No. 25, *The Relationship of Generally Accepted Auditing Standards to Quality Control Standards*, and Statement on Quality Control Standards No. 2 (SQCS No. 2), *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, require the firm to maintain a system of quality control to provide reasonable assurance that its personnel comply with applicable professional standards and the firm's standards of quality. Engagement performance policies and procedures required by paragraph .18 of SQCS No. 2<sup>1</sup> encompass all phases of a firm's policies and procedures for the design and execution of the engagement, which include the concurring partner review for SEC engagements. Accordingly, the concurring partner review is an integral part of the firm's system of quality control and serves as an objective review of significant auditing, accounting, and financial reporting matters<sup>2</sup> that come to the attention of the concurring partner reviewer and the resolution of such matters prior to the issuance of the firm's audit report with respect to financial statements of SEC engagements (see Appendix D, SECPS §1000.38). On the basis of that review, the concurring partner reviewer should conclude that no matters that have come to his or her attention would cause the concurring partner reviewer to believe that the financial statements are not in conformity with generally accepted accounting principles in all material respects, or that the firm's audit was not performed in accordance with generally accepted auditing standards.

A member firm's system of quality control should include policies and procedures covering (a) the qualifications of concurring partner reviewers, (b) the nature, extent, and timing of the concurring partner review, and (c) the documentation required to evidence compliance with the firm's policies and procedures with respect to the concurring partner review requirement.

---

1 The Auditing Standards Board has issued a revision to SQCS No. 2, through adoption of SQCS No. 4, to specify "Where applicable, these policies and procedures should also address the AICPA's SEC Practice Section's concurring partner review requirement for SEC engagements."

2 For purposes of the concurring partner review, "significant auditing, accounting, and financial reporting matters" refers to matters involving a significant risk of material misstatement of financial statements, including a material disclosure deficiency in the footnotes to the financial statements.

**1028 Organizational Structure and Functions of the SEC Practice Section**

As a minimum, the firm's policies and procedures should be responsive to the following:

- a. **Qualifications.** The concurring partner reviewer should have sufficient technical expertise and experience to achieve the purpose described above. The determination of what constitutes sufficient technical expertise and experience requires consideration and is tailored to the circumstances of the engagement, including the personnel assigned to the engagement. An effective concurring partner review contemplates knowledge of relevant specialized industry practices. It also contemplates that the concurring partner reviewer possesses knowledge of SEC rules and regulations in areas where such rules and regulations are pertinent. There are various ways to obtain such knowledge in addition to personal audit experience, such as attendance at relevant training courses and through self-study. The concurring partner reviewer should seek assistance from other individuals to supplement this knowledge when necessary in the circumstances.

The tone set at the top of the firm should encourage and support the performance of objective concurring partner reviews. In this regard, firm policy should state that the concurring partner reviewer is expected to carry out his or her responsibilities with objectivity and due professional care without regard to the relative positions of the audit engagement partner and the concurring partner reviewer. Further, the concurring partner reviewer should not assume any of the responsibilities of the audit partner-in-charge of the engagement<sup>3</sup> or have responsibility for the audit of any significant subsidiaries, divisions, benefit plans, or affiliated or related entities. In addition, a prior audit engagement partner should not serve as the concurring partner reviewer for at least two annual audits following his or her

---

<sup>3</sup> It is not unusual for clients to be aware of the existence of a concurring partner reviewer. A client may contact the concurring partner reviewer with respect to matters requiring immediate attention when the audit engagement partner is not available because of illness, extended travel or other reasons. When a concurring partner reviewer is thus required to deal with an accounting, auditing or financial reporting matter, he or she should advise the audit engagement partner of the facts and circumstances so that the audit engagement partner can review the matter and take full responsibility for its resolution.

**Organizational Structure and Functions of the SEC Practice 1029  
Section**

last year as the audit engagement partner.<sup>4</sup> A member firm that is not subject to the SECPS membership requirement regarding rotation of an audit partner-in-charge of an SEC engagement after seven consecutive years is exempt from the preceding requirement.<sup>5</sup>

- b. **Nature, Extent, and Timing.** The concurring partner reviewer's responsibility is to perform an objective review of significant auditing, accounting, and financial reporting matters and to conclude, based on all the relevant facts and circumstances of which the concurring partner reviewer has knowledge, that no matters that have come to his or her attention would cause the concurring partner reviewer to believe that the client's financial statements covered by the firm's audit report are not in conformity with generally accepted accounting principles in all material respects or that the audit was not performed in accordance with generally accepted auditing standards.

The concurring partner reviewer's responsibility is not the equivalent of the audit engagement partner's responsibilities. Without first-hand knowledge of the client's business environment, the benefit of discussions with management and other client personnel, the opportunity to review client documents or controls, or the ability to observe the client's actions or attitudes, a concurring partner generally is not in a position to make the informed judgments on significant issues expected of an audit engagement partner. However, the concurring partner reviewer is expected to objectively perform the procedures specified below and reach conclusions based on all relevant facts and circumstances of which he or she has knowledge.

The concurring partner reviewer's responsibility is fulfilled by performing the following procedures:

- discussing significant accounting, auditing and financial reporting matters with the audit engagement partner;

---

<sup>4</sup> The SECPS Peer Review Committee may authorize alternative procedures when this requirement imposes an undue hardship on the firm. See SECPS §2000.147, Appendix F, of the SEC Practice Section Reference Manual for submitting requests for a waiver of this requirement to the SECPS Peer Review Committee.

<sup>5</sup> See SECPS §1000.08(e)(1), Requirements of Members, of the SEC Practice Section Reference Manual.

1030 **Organizational Structure and Functions of the SEC Practice Section**

- discussing the audit engagement team's identification and audit of high-risk transactions and account balances;
- reviewing documentation of the resolution of significant accounting, auditing and financial reporting matters, including documentation of consultation with firm personnel or resources external to the firm's organization (such as standard-setters, regulators, other accounting firms, the AICPA, and state societies)<sup>6</sup>;
- reviewing a summary of unadjusted audit differences;
- reading the financial statements and auditors' report; and
- confirming with the audit engagement partner that there are no significant unresolved matters.

These procedures provide the basis for the concurring partner reviewer to perform an objective review of accounting, auditing and financial reporting matters that were considered significant by the engagement team in conducting the audit. The concurring partner reviewer is not responsible for searching for additional matters to be considered by the engagement team. However, significant matters not previously identified by the engagement team that come to the concurring partner reviewer's attention should be referred to and resolved by the engagement team with the concurrence of the concurring partner reviewer.

In addition to performing the procedures described in the bullets above, the concurring partner reviewer's consideration and conclusions about whether significant matters were appropriately considered and resolved may require discussions with other firm personnel involved in any significant consultations. When consultation occurs with the concurring partner reviewer on an accounting, auditing or financial reporting matter during the engagement, the audit engagement

---

<sup>6</sup> Documentation to be reviewed should consist of summary memoranda and/or working paper summaries of the resolution of significant accounting, auditing, and financial reporting matters, and may include selected, more detailed working papers and other documentation. The review of the more detailed working papers and other documentation is a matter of professional judgment made by the concurring partner reviewer about the extent of information necessary to perform an objective review so that he or she has sufficient basis to conclude on the results of the review.

**Organizational Structure and Functions of the SEC Practice 1031  
Section**

partner ordinarily should develop an initial resolution to the matter before consulting the concurring partner reviewer<sup>7</sup>.

The firm's guidelines for concurring partner review should take into account its policies and procedures for planning, supervising and reviewing engagements, and the extent to which those policies provide for the documentation of significant accounting, auditing, and financial reporting matters. The firm's guidelines also should identify the types of engagements for which a timely review should be made of the audit planning by the concurring partner reviewer so that any modifications can be implemented effectively during the performance of the audit. Firms should apply, as a minimum, this procedure to the firm's initial audit of a SEC engagement and other high-risk engagements as defined by the firm for this purpose. Such a definition might be influenced by the complexity of the entity, the engagement personnel's experience with the entity, and their knowledge of the entity's business. Factors to consider in this regard may include the entity's type of business; types of products and services; capital structure; related parties; locations; production, distribution, and compensation methods; any material changes in the entity's business; and whether the entity has plans for a public offering. (See AICPA Professional Standards, Vol. 1, AU section 311, "Planning and Supervision" and AU section 312, "Audit Risk and Materiality in Conducting an Audit".)

If the concurring partner reviewer and the audit partner-in-charge of the engagement have conflicting views regarding important matters, the disagreement should be resolved in accordance with applicable firm policy.<sup>8</sup>

In all cases, the concurring partner review should be completed before the release of the audit report and before the reissuance of the audit report where performance of

---

<sup>7</sup> Consultation with the concurring partner reviewer is most effective when the concurring partner reviewer is aware of and understands the issues at the time the issues are addressed by the audit engagement team rather than addressing the issues at the conclusion of the engagement.

<sup>8</sup> See Statement on Auditing Standards No. 22, *Planning and Supervision*.

**1032 Organizational Structure and Functions of the SEC Practice Section**

subsequent events procedures<sup>9</sup> is required by professional standards.

- c. **Documentation.** The engagement files should contain evidence that the firm's policies and procedures with respect to the concurring partner review requirement were complied with before the issuance of the firm's report. Ordinarily, this would include documentation that the concurring partner reviewer has performed the procedures specified by the firm's policies and that no matters that have come to the attention of the concurring partner reviewer would cause him or her to believe that the financial statements are not in conformity with generally accepted accounting principles in all material respects or that the firm's audit was not performed in accordance with generally accepted auditing standards.

---

<sup>9</sup> In this instance, the concurring partner reviewer ordinarily would concern himself or herself with matters relating to the subsequent events procedures.

**Organizational Structure and Functions of the SEC Practice Section 1033**

**.40 APPENDIX F - Resolution Regarding Failures to Meet Certain Membership Requirements**

**WHEREAS:** Member firms of the SEC Practice Section are required to abide by the requirements of membership including, among other things, the filing of certain information with the Section for each fiscal year, to pay dues as established by the Executive Committee, and to cooperate with the Peer Review Committee in connection with its duties; and

**WHEREAS:** The Executive Committee is authorized to establish general policies for the Section and oversee its activities; and

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

**IT IS HEREBY RESOLVED THAT:**

Membership in the SEC Practice Section shall be suspended thirty days after a firm has been notified by certified mail that it is in default of its obligation to:

- file its annual report to the Section;
- pay its dues;
- file requested information with the Peer Review Committee incident to arrangements for a required peer review;
- have a peer review by the date required;
- pay in full the fees and expenses of a review team appointed by the peer review committee within 60 days of the date when the peer review was accepted by the Peer Review Committee; or
- pay in full the fees and expenses of a special review required by the Quality Control Inquiry Committee within 60 days of the date of the billing for such amounts.

The firm's membership shall be automatically terminated ninety days after the date of suspension if the failure is not sooner corrected or in the case of outstanding financial obligations the firm does not commit to and abide by appropriate payment terms. This resolution is effective immediately and shall be applied to firms in default of any of the aforementioned obligations on the date of the resolution's adoption by the Executive Committee.



1034 Organizational Structure and Functions of the SEC Practice Section

.41 APPENDIX G - Statement of Policy on the Peer Review Program

1. A peer reviewer is ordinarily expected to issue the peer review report and letter of comments, if any, within thirty days of the exit conference. The reviewed firm is ordinarily expected to submit its report, and its letter of comments and response thereto, if applicable, within fifteen days of the date the report and letter of comments were issued. When these timing guidelines are not met, an AICPA staff person or a member of the Peer Review Committee shall determine the reasons for the delay and act accordingly. If in the opinion of such person, after consultation with the chairman of the Peer Review Committee -

a. The delay arises from an unresolved problem or disagreement in the review, an attempt will be made to resolve the matter. At that time, the reviewed firm will be advised that it is under investigation for purposes of SECPS §1000.06 of the Section's organizational structure and functions document.

b. The delay arises from a failure to perform the peer review in a timely, professional manner, the peer review team captain will be advised that the Peer Review Committee will be asked to decide at its next meeting whether to refer the matter to the AICPA Professional Ethics Division as a violation by the peer review team captain of rule 501 of the AICPA Rules of Conduct. (If the review team was organized by a member firm or by a sponsoring association, the managing partner of the firm or the appropriate association representative will be alerted to the problem before the matter is formally voted on by the Peer Review Committee.) In reaching such a decision, the Committee will ordinarily give the peer review team captain a grace period of not less than 15 days to remedy the problem before the referral is made to the Professional Ethics Division. A representation that the problem will be remedied is ordinarily not sufficient to forestall referral to the Professional Ethics Division. Further, in these circumstances the Committee may determine that a firm no longer has the qualifications to be a reviewing firm or that the sponsoring association should no longer be authorized to administer peer reviews.

c. The delay arises from an unreasonable failure by the reviewed firm to comply with its obligations under the peer review standards, the reviewed firm will be advised that it is under investigation for purposes of SECPS §1000.06 and that the Peer Review Committee will be asked at its next meeting to decide to recommend to the chairman of the Executive Committee that a hearing panel be

appointed to consider the imposition of sanctions on the firm. In reaching such a decision, the Committee will ordinarily give the reviewed firm a grace period of not less than 15 days to submit the required documents. A representation that the documents will be submitted is not sufficient to forestall the formal due process procedures related to the conduct of a hearing.

2. Also, when the Peer Review Committee or its staff learns in whatever manner from a peer reviewer, the reviewed firm, or others that the peer review report for a given member firm has been or may be modified or that the peer reviewer believes that the reviewed firm may have issued an inappropriate report on a client's financial statements, the matter shall be investigated by the Peer Review Committee in the manner and to the extent it deems appropriate. (A formal notification to the reviewed firm of such investigation is not required until such time, if any, that the Peer Review Committee decides to recommend to the chairman of the Executive Committee that a hearing panel be appointed to consider the imposition of sanctions on the firm.) Pursuant to SECPS §1000.06, a member firm that is under investigation by the Peer Review Committee is not free to resign until the matter is resolved and until the firm has taken the corrective actions, if any, deemed necessary by the Peer Review Committee. Receipt of a resignation in these circumstances, coupled with a failure to cooperate in re-solving the matter, ordinarily will cause the Peer Review Committee to decide to conduct a hearing for the purpose of determining whether to recommend sanctions against the firm.

1036 Organizational Structure and Functions of the SEC Practice Section

.42 APPENDIX H - Illustrative Statement of Firm Philosophy

The Firm and Its Objectives

ABC & Co. is a partnership engaged in the practice of public accounting in Anytown and Everywhere. ABC & Co. maintains correspondent relationships with selected firms that enable us to meet client needs for services outside our normal practice area.

We have as an overriding objective the provision of high quality audit, accounting, tax, and advisory services to clients in the best professional manner. Our partners and staff are expected to comply with this statement of philosophy in order to achieve that objective.

"Professionalism" in the accounting profession means integrity, objectivity, independence where required, adherence to professional standards and applicable laws and regulations, and a demonstrated will to maintain and improve the quality of professional services and to withstand all pressures, competitive and otherwise, to compromise on principles, standards, and quality. In the field of auditing, particularly, professionalism requires an understanding of and dedication to the public interest.

The public interest in audited financial statements has placed the public accounting profession in a unique position of public trust. Moreover, there is also a significant public interest in the way in which the Firm carries out accounting, tax, and advisory services. Therefore, no client or Firm consideration is allowed to interfere with our ability to carry out our commitment to professionalism.

Professional Performance

ABC & Co. demands integrity, objectivity, competence, and due care from all of its personnel in the conduct of all of its engagements, whatever their nature. We demand independence in fact and appearance in all audit and other engagements where independence is required by applicable laws and regulations and the requirements of professional societies. We take steps to insure that personnel assigned to engagements, whatever their nature, have the professional and specialized knowledge required to carry out their responsibilities; at the same time, we recognize that supervisors and other reviewers and consultants can complement that knowledge.

Our Firm is structured to provide leadership in achieving high quality professional performance while maintaining the concept of individual responsibility so necessary to clients and to individuals within the firm. ABC & Co. has established policies and procedures that we believe provide assurance that professional engagements are properly planned and executed and that decisions are based on the substance of issues, not on form. Accounting

**Organizational Structure and Functions of the SEC Practice Section 1037**

standards cannot deal with all possible situations, and we at all times urge our clients to adopt accounting and reporting policies that we believe are the most appropriate in the circumstances.

Our policies and procedures provide, among other things, for consultation on significant matters, and ABC & Co. has designated partners of the Firm whose opinions are to be sought on significant ethical, technical, and industry questions. The policies and procedures we have established are designed to assure that our clients receive the best professional services we can provide and that in providing those services we continually keep in mind the public interest in our work. We expect our partners and staff to identify and resolve all important issues relevant to an engagement.

More specifically, to achieve high quality professional performance, and to comply with the membership requirements of the AICPA Division for CPA Firms, ABC & Co. has adopted policies and procedures that implement the quality control standards for the conduct of accounting and auditing engagements established by the American Institute of Certified Public Accountants. Those policies and procedures relate to the following elements of quality control, among other matters:

**Independence, Integrity, and Objectivity** - To be free from financial, business, family, and other relationships involving a client when required. To be honest and candid within the constraints of client confidentiality. To have a state of mind and a quality that lends value to the firms services and imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest.

**Personnel Management** - To hire individuals that possess the appropriate characteristics to enable them to perform competently. To assign work to personnel who possess the technical training and competence required in the circumstances. To provide personnel with the training necessary to fulfill responsibilities assigned and satisfy applicable continuing professional education requirements. To select for advancement those individuals that have the qualifications necessary to fulfill responsibilities involved.

**Acceptance and Continuance of Clients and Engagements** - To appropriately consider the risks associated with providing professional services so as to decrease the likelihood of association by the firm with clients and engagements in which client management lacks integrity. To associate with clients and engagements in which the firm can reasonably expect to complete with professional competence.

1038 **Organizational Structure and Functions of the SEC Practice Section**

**Engagement Performance** - To determine that the design and execution of work performed is efficient and in accordance with applicable professional standards. To have personnel refer to authoritative literature or other sources and consult with individuals with the knowledge, technical competency, judgment, and authority, when appropriate.

**Monitoring** - To develop a system to evaluate on an ongoing basis whether the other elements of quality control established by the firm are suitably designed and are being effectively applied.

We have also adopted appropriate policies and procedures in the above areas to guide the conduct of tax and advisory services engagements.

The adequacy of the Firm's quality control system for our accounting and auditing practice and our compliance with that system are independently evaluated every three years through a peer review conducted under the auspices of the AICPA Division for CPA Firms. The peer review report is available to our clients and other interested parties.

**Relationships With Clients**

The value of our services is, to a large degree, dependent on the public perception of our integrity and objectivity. If the public were to doubt our integrity or objectivity - or our competence or professional care - as a result of our work for a given client, the value of our services to that client, to all other clients, and to the public at large could drop significantly. Accordingly, just as our clients are selective in their choice of CPA firms, ABC & Co. is selective in accepting clients. Our responsibilities to existing clients and to the public demand that we consider the appropriateness of client relationships and that we carefully consider the nature of services we are asked to provide and our ability to provide those services in a quality manner in conformity with all relevant professional standards.

When potential clients who disagree with their present auditors on significant auditing, accounting, or reporting questions, request our opinion on the matter, we consult within our Firm and with a potential client's present or predecessor CPA firm before giving our final conclusion on the matter.

We value our reputation for quality services and believe that reputation is the basis on which we attract new clients and build our practice for the future. We are committed to rendering value for our fees and believe our clients should have a reasonable basis for making that judgment for themselves. Accordingly, we carefully evaluate the services we are asked to provide and the factors, such as the nature of control systems and procedures, that will affect

**Organizational Structure and Functions of the SEC Practice 1039  
Section**

the costs we expect to incur in providing such services before we inform present and potential clients of the fees we estimate those services will entail. Once ABC & Co. undertakes a client engagement, we bring all the resources to that engagement necessary in the circumstances.

We do not disclose to anyone outside of our Firm any confidential client information obtained in the course of any engagement unless the disclosure is authorized by the client or is required to discharge properly our responsibilities under law or authoritative regulatory or professional standards. (Our peer reviewers have access to client information, but they are bound by the same standards of confidentiality.)

**Services Provided**

ABC & Co. provides a full range of audit, accounting, tax, and advisory services, consistent with ethical and professional standards and regulatory requirements in the United States and with the limitations imposed by our Firm's membership in the AICPA Division for CPA Firms.

The services provided by CPA firms must be responsive to changes in the environment, which is affected by developments in information technology, the increasing complexity of tax laws and regulations, greater demands by the public for new types of information and CPA assurances on such information, the increasing need of many clients for advisory services, and a host of other factors.

If the public accounting profession as a whole, and ABC & Co. in particular, are to meet the legitimate and changing needs of clients and the public, arbitrary restrictions on the services provided are not appropriate. However, ABC & Co., as a matter of policy, will undertake only engagements that we believe we can perform with competence, that will be useful to our clients or to appropriate third parties, that will not impair our independence in fact or appearance when we also provide audit services to the client involved, and that will help attract and retain the personnel we need to provide the knowledge base essential to maintain our ability to serve our clients and the public in a professional manner. In evaluating proposed engagements, as well as the way we inform clients and others of our capabilities, we consider whether such engagements will lessen public confidence in our independence, integrity, and objectivity in the performance of the audit function or in our commitment to that function.

1040 Organizational Structure and Functions of the SEC Practice Section

.43 APPENDIX I - Standard Form of Letter Confirming the Cessation of the Client-Auditor Relationship

(Date)

Mr. John Doe  
Chief Financial Officer  
XYZ Corporation  
Anytown, USA

Dear Mr. Doe:

This is to confirm that the client-auditor relationship between XYZ Corporation (Commission File Number X-XXXX) and Able Baker & Co. has ceased.

Sincerely,

Able Baker & Co.

cc: Office of the Chief Accountant  
SECPS Letter File  
Securities and Exchange Commission  
Mail Stop 9-5  
450 Fifth Street, N.W.  
Washington, D.C. 20549

NOTE: The SEC has indicated that member firms may satisfy the SECPS notification requirements by faxing a copy of the SECPS letter to the SEC-Office of the Chief Accountant (202/942-9656; Attn: SECPS Letter File/Mail Stop 9-5). A copy of the fax log should be retained by the sender as documentation of timely filing and a back-up copy of the letter should be sent by regular mail to the SEC. The SEC strongly encourages sending the notification letter by fax and will accept the date of the fax as the notification date. If a fax transmission is not available, alternatively, by order of preference, the SECPS notification letter may be sent to the SEC via (1) U.S. Postal Service overnight delivery, (2) commercial overnight courier, or (3) certified mail; "return receipt requested".

The exact name of the registrant, the Commission File Number as it appears on the cover page of the Form 10-K, and the complete SEC address, as shown above, should be used in the letter and on the envelope. If the cessation of the client-auditor relationship affects multiple SEC

**Organizational Structure and Functions of the SEC Practice 1041  
Section**

registrants (e.g., a parent with publicly-registered subsidiaries, series of mutual funds), the exact name of each registrant and each Commission File Number should be set forth in the SECPS letter.



**1042 Organizational Structure and Functions of the SEC Practice Section**

**.44 APPENDIX J - SEC Practice Section Dues**

1. The Executive Committee of the SEC Practice Section established the following dues structure (effective January 1, 2000):

Dues will be assessed on a calendar year basis and will be billed annually as of January 1. The amount due will be determined based on the number of CPAs in the firm, including partners, plus the number of SEC clients for which the firm is auditor of record. The amount due will be calculated based on the information reported in the firm's most recent annual report to the Section.

2. The Executive Committee determined that the dues will be \$25.00 per CPA employed in the firm, and \$170 per SEC client. In any event, the firm's minimum annual dues assessment shall not be less than \$500 plus the assessment per SEC client. Dues will be prorated on a monthly basis for firms that join the Section during the year for amounts in excess of the \$500 minimum.

**.45 Appendix K - SECPS Member Firms With Foreign Associated Firms  
That Audit SEC Registrants**

.01 The Section acknowledges that SECPS member firms that are members of, correspondents with, or similarly associated with international firms or international associations usually do not control their international organization or individual foreign associated firms<sup>1</sup>. However, the Section adopted the membership requirement set forth in SECPS §1000.08(n) to obtain the assistance of SECPS member firms in their seeking to enhance the quality of SEC filings by SEC registrants<sup>2</sup> whose financial statements are audited by foreign associated firms. This assistance consists of SECPS member firms seeking adoption of policies and procedures by their international organizations or individual foreign associated firms that are consistent with the following objectives:

- a. Procedures for Certain Filings by SEC Registrants - The policies and procedures should address the performance of procedures with respect to certain SEC filings by SEC registrants that are clients of foreign associated firms by a person or persons knowledgeable in accounting, auditing, and independence standards generally accepted in the U.S., independence requirements of the SEC and ISB, and SEC rules and regulations in areas where such rules and regulations are pertinent (the "filing reviewer"). The procedures are performed to provide assistance to the partner of the foreign associated firm responsible for the audit (the "audit partner-in-charge of the engagement") and the foreign associated firm. Such filings are limited to registration statements, annual reports on Form 20-F and 10-K, and other SEC filings that include or incorporate the foreign associated firm's audit report on the financial statements of an SEC registrant.

---

<sup>1</sup> For this purpose, a foreign associated firm is a firm domiciled outside of the United States and its territories that is a member of, correspondent with, or similarly associated with an international firm or international association of firms with which the SECPS member is associated.

<sup>2</sup> See Appendix D, SECPS §1000.38, "Definition of an SEC Engagement" for purposes of determining compliance with the membership requirements of SECPS §1000.08e, f, g, h, i, k, m, n and o.

**1044 Organizational Structure and Functions of the SEC Practice Section**

The procedures performed by the filing reviewer should generally include the following:

- (1) Reading the document to be filed with the SEC with particular attention given to compliance as to form of the financial statements (and related schedules) and auditors' report with the applicable accounting and financial reporting requirements for such filings by the SEC registrant.
- (2) Discussing with the audit partner-in-charge of the engagement:
  - (i) the engagement team's familiarity with and understanding of the applicable U.S. auditing, accounting, financial reporting, and independence standards, including independence requirements of the SEC and the ISB;
  - (ii) the significant differences between: (a) the accounting and financial reporting standards used in the presentation of the financial statements included or incorporated in the document to be filed with the SEC and those applicable in the U.S., and (b) the auditing and independence standards of the foreign associated firm's domicile country and those applicable in the U.S.; and
  - (iii) any significant auditing, accounting, financial reporting, and independence matters that come to the attention of the filing reviewer when performing the procedures described above, including how any such matters were addressed and resolved by the audit partner-in-charge of the engagement.
- (3) Documenting the results of the procedures performed.

The procedures performed by the filing reviewer described above do not relieve the audit partner-in-charge of the engagement of any of the responsibilities for the performance of the audit of, and the report rendered by the foreign associated firm on, the financial statements included in the document to be filed with the SEC. Also, the filing reviewer does not assume any of the

**Organizational Structure and Functions of the SEC Practice 1045  
Section**

responsibilities of the audit partner-in-charge of the engagement or of any concurring reviewer.

Because of the limited nature of the procedures described above, it is recognized that the filing reviewer can not and does not assume any responsibility for detecting a departure from, or noncompliance with, accounting, auditing, and independence standards generally accepted in the U.S., independence requirements of the SEC and ISB, or SEC rules and regulations.

- b. Inspection Procedures - The policies and procedures should address the review of a sample of audit engagements performed by foreign associated firms for clients that are SEC registrants. Such reviews may be performed as part of an annual inspection program of the international organization or the individual foreign associated firms. The reviews of engagements should be performed by a person or persons knowledgeable in accounting, auditing, and independence standards generally accepted in the U.S., independence requirements of the SEC and ISB, and SEC rules and regulations in areas where such rules and regulations are pertinent (the "inspection reviewer"). The need for knowledge of relevant specialized industry practices should be considered.

Based on the procedures performed, the inspection reviewers should determine whether anything came to their attention to cause them to believe that:

- (1) the financial statements were not presented in all material respects in conformity with accounting principles generally accepted in the U.S. or, if applicable, the footnote reconciliation of the financial statements to U.S. GAAP did not include appropriate treatment of the material reconciling items,
- (2) the audit engagement was not performed in accordance with auditing standards generally accepted in the U.S.,
- (3) the document(s) filed with the SEC did not comply as to form of the financial statements (and related schedules) with pertinent SEC rules and regulations for such filings,
- (4) the foreign associated firm did not comply with the

**1046 Organizational Structure and Functions of the SEC Practice Section**

applicable U.S. independence standards, including independence requirements of the SEC and ISB with respect to the SEC registrant, or

- (5) the foreign associated firm did not comply with procedures consistent with those described in .01a. above.

c. Disagreements - The policies and procedures should provide that if the filing or inspection reviewer and the audit partner-in-charge of the engagement have conflicting views as to the resolution of matters that came to the attention of the filing or inspection reviewer when performing the procedures for certain filings or inspection described above, that disagreement should be resolved in accordance with the applicable policy of the international organization or of the filing or inspection reviewer's firm.

.46 APPENDIX L - Independence Quality Controls

Introduction

Member firms must comply with the independence standards promulgated by the American Institute of Certified Public Accountants (AICPA), Independence Standards Board (ISB), and the Securities and Exchange Commission (SEC). The importance of compliance with such independence standards, and the quality control standards promulgated by the AICPA, should be reinforced by the management of the member firm, thereby setting the appropriate "tone at the top" and instilling its importance into the professional values and culture of the member firm. Member firm management should also foster an environment where the seriousness and importance of compliance can be evidenced in many forms, such as the firm's commitment to the training of professionals on independence policies and the action taken in the case of non-compliance with such policies. The following requirements, unless otherwise noted, apply only to the U.S. member firm practice.

Requirements

1. Each member firm shall establish independence policies covering relationships between the member firm, its benefit plans, and its professionals (and the close relatives of such professionals) and "restricted entities" of the firm. These policies shall be written in language, to the extent possible, that is clear, concise, and tailored to each firm's independence policies and procedures, given the complexity of the member firm's practice. These relationships would include investments, loans, brokerage accounts, business relationships, employment restrictions, proscribed services, and fee arrangements. For purpose of this membership requirement, "restricted entities" shall include all audit clients of the member firm that are SEC registrants and all entities<sup>1</sup> related to such clients for which

---

<sup>1</sup> Examples of a restricted entity may include clients and non-clients such as (a) partnerships where a general partner sponsors or manages a limited partnership that is an audit client, (b) plan sponsors of single-employer sponsored employee benefit plan audit clients that are subject to ERISA, (c) advisors or sponsors of a mutual fund that is an audit client, (d) governmental component units as those terms are defined in AICPA Ethics Interpretation 101.10 or (e) parent companies and material investors. For practical purposes, member firms may exclude entities whose securities are not available for public sale.

**1048 Organizational Structure and Functions of the SEC Practice Section**

the member firm must maintain independence under the SEC, ISB or relevant AICPA independence standards.

- a. Persons classified as "professional staff" (including partners) in a member firm's annual report to the SEC Practice Section (SECPS) shall be considered "professionals" for this purpose.
  - b. For purposes of implementing these requirements, the term "SEC registrant" is defined as (1) an issuer making an initial filing, including amendments, under the Securities Act of 1933 or 1934; (2) a registrant that files periodic reports under the Investment Company Act of 1940 or the Securities Exchange Act of 1934; (3) a bank or other lending institution that files periodic reports with the Comptroller of the Currency, the Federal Reserve System, the Federal Deposit Insurance Corporation, or the Office of Thrift Supervision; (4) a company whose financial statements appear in the annual report or proxy statement of an investment fund because it is a sponsor or manager of such a fund, but which is not itself a registrant required to file periodic reports under the 1940 Act or section 13 or 15(d) of the 1934 Act; and (5) a foreign private issuer defined by Rule 405 of Regulation C under the Securities Act of 1933 and Rule 3b-4(c) under the Securities Act of 1934 that has securities registered or has filed a registration statement with the SEC.
2. The member firm's independence policies shall be made available to each professional and changes thereto shall be communicated on a timely basis. These policies are to be made available to all U.S. professionals (as defined in paragraph 1(a)) and to partners and managers<sup>2</sup> in foreign-associated

---

<sup>2</sup> Member firms with at least 7,500 professionals shall make available the firm's independence policies to partners and managers in its foreign-associated firms by March 31, 2000. Member firms with at least 1,000 professionals, but less than 7,500 professionals, shall make available the firm's independence policies to partners and managers in its foreign-affiliated firms that have SEC registrants by September 30, 2000. Member firms with less than 1,000 professionals shall make available the firm's independence policies to partners and managers in its foreign-affiliated firms that have SEC registrants by December 31, 2000.

**Organizational Structure and Functions of the SEC Practice Section 1049**

firms<sup>3</sup>. Each professional performing professional services for clients shall complete near the time of initial employment and periodically thereafter, independence training as required by the member firm's policies. The specific content and extent and timing of the independence training requirements shall be determined by the member firm's policies, but shall include the relevant rules regarding investments, loans, brokerage accounts, business relationships, employment restrictions, proscribed services and fee arrangements that are applicable to the firm and professionals and their close relatives.

3. Each member firm shall maintain a database ("Restricted Entity List") that includes, at a minimum, all restricted entities. The firm's policies should explain why, when and how SEC registrant attest clients (and other related entities as discussed above) are to be placed on or deleted from the Restricted Entity List<sup>1</sup>. For member firms with at least 7,500 professionals, an electronic tracking system and automated restricted entity database are required. The electronic system shall allow the firm to match timely U.S. partner and manager investment holdings to the member firm's restricted entity list. Member firms with at least 7,500 professionals are required to have the electronic tracking system in place by December 31, 2000.
4. Each member firm shall designate a senior-level partner responsible for (1) keeping the Restricted Entity List updated on at least a monthly basis, (2) making it readily available to all personnel who are required to comply with independence restrictions, (3) communicating additions to the list on a timely basis (generally monthly), and (4) overseeing the adequate functioning of the independence policies of and the consultation process within the member firm.
5. Each member firm's independence policies and procedures should specifically require the following:

---

<sup>3</sup> §1000.08(n) in the *SEC Practice Section Reference Manual* defines a foreign associated firm as a firm domiciled outside of the United States and its territories that is a member of, correspondent with, or similarly associated with an international firm or international association of firms with which the SECPS member firm is associated. For purposes of complying with paragraph 2 of this requirement, the SECPS member firm is required to make available the firm's independence policies only to those foreign-associated firms which are reported on the member firm's annual report to the SECPS.



**1050 Organizational Structure and Functions of the SEC Practice Section**

- a. Prior to acquiring any security in an entity, obtaining a loan from an entity, opening or modifying a brokerage account with an entity, professionals required to comply with restrictions should review the Restricted Entity List to determine whether the entity is included thereon. This review would also be required for similar activities by the professional's spouse or dependents.
- b. Each professional shall certify near the time of initial employment and at least annually thereafter that he or she (1) has read the firm's independence policies, (2) understands their applicability to his or her activities and those of his or her spouse and close relatives, and (3) has complied with the requirements of the firm's independence policies since the prior certification<sup>4</sup>.
- c. Each professional shall report apparent violations of policies involving himself or herself and his or her spouse and dependents when identified and the corrective action taken or proposed to be taken on a timely basis. Reporting apparent violations under this requirement would not include for example, timely disposition of client securities resulting from additions to the Restricted Entity List or upon becoming a member as defined by ISB, SEC or relevant AICPA independence rules.
- d. Each member firm shall have a monitoring system under the supervision of the senior-level partner designated in above to determine that adequate corrective steps are taken and documented on all apparent violations reported by professionals within the U.S. member firm. The monitoring system should include procedures to ensure that information received from its U.S. partners and managers is complete and accurate as to the requirements described in paragraph 5(b). An example of such a procedure may include auditing, on a sample basis, selected information such as brokerage statements, etc.

---

<sup>4</sup> The provisions of paragraph 5(b) are effective April 1, 2000 for firms with at least 7,500 professionals and shall be applied prospectively.

**Organizational Structure and Functions of the SEC Practice 1051  
Section**

- e. Each member firm shall develop as part of its policies, guidelines for actions to be taken against individuals for violation of independence by its professionals. These policies will describe the potential sanctions to levy against those individuals for violating firm or professional independence requirements or a firm's policies and procedures.

**EFFECTIVE DATE**

The membership requirement is effective in accordance with the dates set forth in the respective paragraphs. However, all requirements set forth in this membership requirement are effective no later than December 31, 2000.

**Section 2000**

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

## NOTICE TO READERS

This section titled *Standards for Performing and Reporting on Peer Reviews* is amended from time to time by the members of the Peer Review Committee of the SEC practice Section of the AICPA Division for CPA Firms (the Committee) in accordance with its voting procedures, which require that a majority of members approve the issuance of standards. The Committee is authorized to establish standards for conducting and reporting on peer reviews in the section titled *Organizational Structure and Functions of the SEC Practice Section of the AICPA Division for CPA Firms (SECPS §1000)*, adopted by resolution of Council of the AICPA.

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

### SECPS Peer Review Committee ( 1999 - 2000 )

W. Ronald Walton, Chair  
John L. (Arch) Archambault  
Edward L. Buchanan IV  
Spencer A. Coates  
John C. Compton  
Anthony A. Cuzzo, Jr.  
Robert E. Fleming  
Bradley R. Gabosh  
Dale P. Lien

John J. Lucas  
Charles J. McElroy  
Richard L. Miller  
Guy W. Moore, Jr.  
Thomas J. Parry  
Edward F. Smith  
David J. Steiner  
Kim L. Tredinnick  
David W. Truesdell

### AICPA STAFF

Susan S. Coffey  
Vice President  
Self Regulation & SECPS

Sheri L. Fabian  
Senior Technical Manager  
SECPS Peer Review Program

David T. Brumbeloe  
Director  
SEC Practice Section

## SECPS Section 2000

## STANDARDS FOR PERFORMING AND REPORTING ON PEER REVIEWS

## TABLE OF CONTENTS

<u>Section</u>	<u>Paragraph</u>
2000 Standards for Performing and Reporting on Peer Reviews	
Introduction .....	.01 - .07
Performing Peer Reviews .....	.08 - .93
Objectives of the Peer Review .....	.08 - .09
General Considerations .....	.10 - .25
Confidentiality .....	.10 - .11
Independence, Integrity, and Objectivity .....	.12 - .23
Competence .....	.24 - .25
Due Professional Care .....	.26
Organization of the Review Team .....	.27 - .31
Qualifications for Individuals to Serve as Reviewers .....	.32 - .34
Qualifications for a Reviewing Firm .....	.35 - .39
Capability .....	.37 - .38
Correspondent Firms .....	.39
The Review .....	.40 - .93
Definitions .....	.40 - .42
General Considerations .....	.43
Scope of the Review .....	.44 - .49
Acquisition and Divestment .....	.50
Restriction of Scope .....	.51
Obtain an Understanding of the Nature and Extent of the Accounting and Auditing Practice .....	.52 - .53
Obtain an Understanding of the Design of the System of Quality Control .....	.54
Obtain an Understanding of the Effectiveness of the Monitoring Procedures Performed Since the Last Peer Review .....	.55 - .56
Obtain an Understanding of the Reviewed Firm's Monitoring Policies and Procedures .....	.55
Obtain an Understanding of the Effectiveness of the Monitoring Procedures Performed .....	.56
Assess Inherent and Control Risk .....	.57 - .66
Determine the Effects of the Current Year's Inspection Procedures on the Peer Review ...	.61 - .62
Test the Effectiveness of the Current Year's Inspection Procedures .....	.63 - .66

## TABLE OF CONTENTS

<u>Section</u>	<u>Paragraph</u>
2000	Select Offices and Engagements for Review . . . . .67 - .75
	Relationship of Risk to Scope . . . . .68 - .69
	Relationship of Inspection Procedures to Scope . . . . .70 - .71
	Other Matters to Consider . . . . .72 - .75
	Special Engagement Selection Considerations . . .76 - .77
	Reasonableness of Scope . . . . .78 - .79
	Documentation of Planning . . . . .80 - .81
	Extent of Compliance Tests . . . . .82
	Location of Documentation . . . . .83
	Extent of Engagement Review . . . . .84 - .90
	Expansion of Scope . . . . .91
	Completion of the Review . . . . .92 - .93
	Review Team Working Papers . . . . .94 - .97
	Reporting on Peer Reviews . . . . .98 - .124
	The Review Team's Report . . . . .98 - .103
	Reporting Considerations . . . . .104 - .106
	Design Deficiencies . . . . .107 - .110
	Noncompliance With Quality Control Policies and Procedures . . . . .111 - .113
	Noncompliance With Membership Requirements . . .114 - .115
	Letter of Comments . . . . .115 - .120
	Contents of the Letter . . . . .116 - .118
	Matters to Be Included in the Letter of Comments . . . . .119 - .120
	Letter of Response . . . . .121
	Engagement Terminated Before Completion . . . . .122 - .123
	Disagreement Within Review Teams . . . . .124
	Committee Consideration of Reports on Peer Reviews . . . . .125 - .135
	Disagreement Between Committee and Review Team . . . . .133 - .135
	Effective Date . . . . .136
 Exhibits	
	A - Flow of Peer Review Working Papers Relating to Engagements (Multi-office Firms) . . . . .137
	B - Flow of Peer Review Working Papers Relating to Engagements (Single-Office Firms) . . . . .138
	C - Review of Engagements . . . . .139
	D - Design Deficiencies . . . . .140

## TABLE OF CONTENTS

<u>Section</u>	<u>Paragraph</u>
2000 Exhibits (Continued)	
E - Compliance Deficiencies (Other Than With a Membership Requirement) .....	.141
F - Flow of Peer Review Office and Engagement Selection .....	.142
Appendixes	
A - Interpretation: Independence, Integrity, and Objectivity .....	.143
B - Interpretation: Selecting the Review Year .....	.144
C - Work Performed by Other Auditors .....	.145
D - Selecting Engagements for Review .....	.146
E - Interpretation: Communicating Engagements Selected to the Reviewed Firm .....	.147
F - Interpretation: Alternative Concurring Partner Review Arrangements .....	.148
G - Interpretation: Alternative Partner Assignment Arrangements .....	.149

**INTRODUCTION**

- .01 The membership requirements of the SEC Practice Section of the AICPA Division for CPA Firms (the Section) provide that a member firm must adhere to quality control standards established by the AICPA and have a peer review of its accounting and auditing practice and its compliance with membership requirements of the Section every three years or at such additional times as designated by the Executive Committee of the Section. (See SECPS §1000.24-.27.) The peer reviews are subject to the administrative control of the SECPS Peer Review Committee (the Committee) and to oversight by the Public Oversight Board.
- .02 This section contains the standards for performing and reporting on peer reviews for the Section. These standards have been developed by the Committee for use by the Section and do not apply to reviews other than those conducted for the Section. Peer reviews intended to meet the membership requirements of the Section must be conducted in accordance with these standards.<sup>1</sup>
- .03 As used herein, the term **review team** refers to a team that is-
- a. Appointed by the Committee (also known as a CART review).
  - b. Formed by a member firm engaged by the firm under review (a firm-on-firm review).
  - c. Formed by an association of CPA firms authorized by the Committee to conduct peer reviews.
- .04 The purpose of a firm's considering the five elements of quality control and adopting quality control policies and procedures for its accounting and auditing practice is to provide the firm with reasonable assurance of conforming with professional standards in the conduct of its accounting and

---

<sup>1</sup> The terms **review** and **peer review** are used interchangeably in this section.



## 2006 Standards for Performing and Reporting on Peer Reviews

auditing practice.<sup>2</sup>

- .05 The quality control policies and procedures adopted by a member firm will depend in part upon the firm's organizational structure, including factors such as its size, the degree of operating autonomy allowed to its personnel and its offices,<sup>3</sup> the knowledge and experience of its personnel, the nature and complexity of its practice, and appropriate cost benefit considerations.
- .06 A member firm is required to make available to the review team a description of the quality control policies and procedures incorporated in its system of quality control. This requirement is met by furnishing a quality control policies and procedures questionnaire.<sup>4</sup>
- .07 The standards encompassed herein are applicable to reviewing entities (review teams) and to individual reviewers (review team members) who perform or are involved in performing peer reviews. They also impose obligations on firms being reviewed.

### PERFORMING PEER REVIEWS

#### Objectives of the Peer Review

- .08 A peer review is intended to provide the reviewer with a reasonable basis for expressing an opinion on whether, during the year under review-

---

<sup>2</sup> Accounting and auditing practice refers to all audit, attest, accounting and review, and other services for which standards have been established by the AICPA Auditing Standards Board or the AICPA Accounting and Review Services Committee under rule 201 or 202 of the AICPA Code of Professional Conduct (AICPA, Professional Standards, vol. 2, ET secs. 201 and 202) and standards for audits covered by *Government Auditing Standards* (the Yellow Book), issued by the U.S. General Accounting Office (GAO). Standards may also be established by other AICPA senior technical committees; engagements that are performed in accordance with those standards are not encompassed in the definition of an accounting and auditing practice.

<sup>3</sup> Offices, as used in these standards, refer to practice offices or other meaningful organizational segments of a firm's system of quality control.

<sup>4</sup> The quality control policies and procedures questionnaire is contained in the Peer Review Program Guidelines, PRM Section 13200, of the SEC Practice Section Peer Review Program Manual.

- a. The reviewed firm's system of quality control for its accounting and auditing practice has been designed to meet the requirements of the quality control standards established by the AICPA.
  - b. The reviewed firm's quality control policies and procedures were being complied with to provide the firm with reasonable assurance of conforming with professional standards.
  - c. The reviewed firm was complying with the membership requirements of the SEC Practice Section of the AICPA Division for CPA Firms in all material respects.
- .09 Upon completion of a peer review, the review team communicates its findings to the reviewed firm and prepares a written report in accordance with the standards for reporting on peer reviews. The review team also prepares a letter of comments when applicable.

### General Considerations

#### **Confidentiality**

- .10 A peer review should be conducted in compliance with the confidentiality requirements set forth by the AICPA in the section of the AICPA Code of Professional Conduct titled "Confidential Client Information" (AICPA, *Professional Standards*, vol. 2, ET sec. 301). Information obtained because of the review concerning the reviewed firm or any of its clients or personnel, including the findings of the review, is confidential. Such information should not be disclosed by review team members to anyone not associated with the review.<sup>5</sup>
- .11 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. Rule 301 of the AICPA Code of Professional Conduct contains an exception to the confidentiality requirements so that a review of a member's professional practice under AICPA authorization is not prohibited. Some state statutes or ethics rules promulgated by state boards of accountancy may, however, not clearly provide a similar exception regarding client

---

<sup>5</sup> The phrase **associated with the review**, as used in this section, includes members, designees, and staffs of the SECPS Executive Committee, SECPS Peer Review Committee, Public Oversight Board, and, if the firm has agreed to its involvement, the Quality Control Inquiry Committee.

## 2008 Standards for Performing and Reporting on Peer Reviews

confidentiality<sup>6</sup>. Accordingly, a reviewed firm may wish to consult its legal counsel to determine whether any action is required to permit client engagement files to be made available to the review team.

### ***Independence, Integrity, and Objectivity***<sup>7</sup>

- .12 Independence (in fact and in appearance) should be maintained with respect to the reviewed firm by a reviewing firm, by review team members, and by any other individuals who participate in or are associated with the review. The AICPA Code of Professional Conduct does not specifically consider relationships between reviewers, reviewed firms, and clients of reviewed firms. However, the concepts concerning independence, integrity, and objectivity embodied in the Code should be considered for their application.
- .13 *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 in the peer review should be free from any obligation to, or interest in, the reviewed firm or its personnel. The concepts in the sections of the AICPA Code of Professional Conduct titled "Article III-Integrity" and "Article IV-Objectivity and Independence" (AICPA, *Professional Standards*, vol. 2, ET secs. 54 and 55), plus rules 101 and 102, their Interpretations, and their Rulings, should be considered in making independence judgments. *Integrity* requires the review team to be honest and candid within the constraints of 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 reviewing firm's services. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest.
- .14 Reciprocal reviews are not permitted. This prohibition is applicable to a reviewing firm. In addition, when the review is conducted by a committee or association of CPA firms, no professional of the reviewed firm may serve as a reviewer of

---

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

<sup>7</sup> See Appendix A, SECPS §2000.142, "Interpretation: Independence, Integrity, and Objectivity", for additional guidance and examples of how the independence requirements are to be interpreted.

the firms whose personnel participated in the reviewed firm's most recent peer review.<sup>8</sup>

- .15 The review team members and, in the case of a firm-on-firm review, the reviewing firm and its personnel are not precluded from owning securities of clients of the reviewed firm. However, a review team member who owns securities of a reviewed firm's client shall not review the engagement of that client because independence would be considered impaired. In addition, the effect on independence of family relationships (spouses, close relatives) and other relationships and the possible loss of the appearance of independence must be considered when assigning team members to review individual engagements.
- .16 In assessing the possibility of an impairment of independence, reviewing firms should consider any family or other relationships between the senior managements at organizational and functional levels of the reviewing firm and the firm to be reviewed.
- .17 For the purposes of the program, independence is impaired when two or more firms or a group of firms (whether a formal or informal group) are involved in jointly marketing or selling services on behalf of one or more identifiable firms, unless the representations in the marketing or selling materials concerning the quality of the firms or their services are objective or quantifiable. When independence is impaired, the firms involved in the joint marketing or selling activities are precluded from participating in the peer review of another of the identifiable firms.
- .18 Some reviewers or their firms may have continuing arrangements with other firms whereby fees, profits, office facilities, or professional staff are shared, or joint ownership of a for-profit entity exists. In these situations, independence for purposes of the program is impaired.
- .19 For purposes of the program, independence is impaired when the reviewers' firm and the firm subject to peer review have

---

<sup>8</sup> For example, assume member firm A is reviewed by a team composed of a team captain who is a partner of member firm B, a partner of member firm C, and a manager from member firm D. No professional in member firm A may be assigned as a member of a team reviewing member firms B, C, or D until the next review of firm A is completed.

## 2010 Standards for Performing and Reporting on Peer Reviews

arrangements with the same non-CPA entity<sup>9</sup> in that the partners of both firms are also employees of that non-CPA entity, and remit revenues and or profits to the non-CPA entity for payment of the lease of employees, offices facilities, equipment or other services provided by the non-CPA entity. When independence is impaired, the firms involved with the non-CPA entity are precluded from participating in the peer review of one another or other firms related to the non-CPA entity.

- .20 Some firms perform engagement correspondent work for other firms. The correspondent firm's fee may be paid by the referring firm or directly by the client. In either situation, if the fees for the correspondent work are material to the reviewed firm, the reviewing firm, or the firm of any member of the review team, independence for purposes of the program is impaired.
- .21 Services provided by one accounting firm for another accounting firm do not impair independence provided certain conditions are met.
- .22 A reviewing firm or a review team member should not have a conflict of interest with respect to the reviewed firm or to clients of the reviewed firm that are the subject of engagements reviewed.
- .23 All individuals involved in the peer review process should recognize that the federal securities laws governing insider trading may apply to them.

### Competence

- .24 A review team should have current knowledge of the professional standards applicable to the type of practice to be reviewed, including appropriate experience in the industries in which the reviewed firm practices. For reviews of firms with clients that must file reports with the SEC or other regulatory bodies, review teams must use reviewers who are knowledgeable about current rules and regulations of such regulatory bodies.
- .25 In determining the composition of a review team, consideration should be given to the areas to be reviewed and the expertise required for various segments of the review.

---

<sup>9</sup> Including all entities owned or controlled by a common parent company

**Due Professional Care**

- .26 Due professional care, as addressed by the AICPA Code of Professional Conduct in the section titled Article V-Due Care (AICPA, Professional Standards, vol. 2, ET sec. 56), should be exercised in the performance of the review, the preparation of the report, and, if applicable, the letter of comments.

**Organization of the Review Team**

- .27 A committee or association of CPA firms appointed review team must be organized so that any individual firm does not provide more than one member of the team unless approved by the Committee or its appointed staff.
- .28 A review team consists of one or more individuals, depending upon the size and nature of the reviewed firm's practice. One member of the review team is designated as the team captain. That individual is responsible for supervising and conducting the review, communicating the review team's findings to the reviewed firm, preparing the report, and, if applicable, the letter of comments on the review. To qualify as a review team captain, a person shall be currently involved in the accounting and auditing practice and be a partner in a member firm that has had a peer review conducted in accordance with the standards adopted by the Section.<sup>10</sup> That firm's most recent Committee-accepted peer review report shall be unmodified. If the individual is associated with more than one firm, then all of the firms the individual is associated with should have received an unmodified report on the peer review of their accounting and auditing practice. For a multi-office firm, the reviewers visiting a selected practice office must be under the direction, at that location, of a partner currently involved in the accounting and auditing practice who supervised the conduct of the review and the work performed at that location (subject to the overall direction of the team captain).

---

<sup>10</sup> As used in this section, partner refers to an individual who is legally a partner, owner, or shareholder in a CPA firm or a sole practitioner. Such individuals should be party to any partnership, ownership or shareholder agreement of a CPA Firm. Under Rule 505, "Form of Organization and Name", of the Code of Professional Conduct, a CPA firm is defined as the practice of public accounting in a form of organization permitted by state law or regulation whose characteristics conform to resolutions of Council (AICPA, Professional Standards, vol. 2, ET sec. 505.)

## **2012 Standards for Performing and Reporting on Peer Reviews**

- .29 An individual who serves as team captain for three successive reviews of the same firm may not serve in that capacity for the firm's next peer review.
- .30 The peer review program assumes that the review team captain will have significant involvement in the conduct of the review, including the planning of the review, and will attend the firm-wide exit conference. (For reviews of multi-office firms, the overall team captain may not consider it necessary to attend the exit conference of every office visited; however, the work of review teams at each organizational level should be supervised by a partner.) Regardless, the review team captain should be involved in discussions of significant findings on the review, and should interact with the reviewed firm and the review team during the conduct of the review.
- .31 A review team captain should possess current knowledge of the peer review process. Accordingly, a review team captain must have obtained this current knowledge either by attending a reviewers' training course that uses AICPA materials and that was conducted within five years or by serving as a Committee member within five years preceding commencement of the review.

### **Qualifications for Individuals to Serve as Reviewers**

- .32 The nature and complexity of a peer review require the exercise of professional judgment. Accordingly, an individual serving as an engagement reviewer shall be a CPA and shall possess current knowledge of accounting and auditing matters. This includes knowledge about current rules and regulations applicable to the industry for which engagements are reviewed. Such knowledge may be obtained from on-the-job training, training courses, or a combination of both. A reviewer shall be currently active at a supervisory level in the accounting and auditing practice of a member firm—for example (a) as a partner or manager with a member firm, (b) in an equivalent supervisory position with a CPA firm, or (c) as a sole practitioner. To be considered currently active in the accounting and auditing practice, a reviewer should be currently involved in the accounting and auditing practice of a firm supervising one or more of the firm's accounting and auditing engagements or carrying out a quality control function with respect to the firm's accounting and auditing practice. To qualify as a review team member, a person also should be associated with a member firm that has had a peer review conducted in accordance with the standards adopted by the Section. That firm's most recent Committee-accepted peer review report shall be unmodified. If the individual is associated with more than one firm, then all of the firms the

individual is associated with should have received an unmodified report on the peer review of their accounting and auditing practice.

- .33 A reviewer of an engagement should possess not only current knowledge of professional standards, but also current knowledge of the accounting and financial reporting practices specific to the industry in which the client operates. The reviewer of an engagement in a high-risk and complex industry should also have current practice experience in that area, including expertise in SEC rules and regulations, if applicable.
- .34 When required by the nature of the reviewed firm's practice, individuals (consultants) who are not CPAs but who have expertise in specialized areas may be used.

#### Qualifications for a Reviewing Firm

- .35 When a member firm is requested to perform a peer review, the criteria discussed in SECPS 2000.35-.37 should be considered by the firm in determining its capability to perform the peer review before accepting the engagement.<sup>11</sup> Individuals selected by the member firm to participate as review team members should possess the requisite qualifications for reviewers or consultants.
- .36 Before performing a peer review, the reviewing firm should have had a peer review of its accounting and auditing practice in accordance with the Section's membership requirements, and its most recent Committee-accepted peer review report should be unmodified. A reviewing firm that does not meet these requirements must receive the Committee's authorization to perform a peer review.

---

<sup>11</sup> If the reviewed firm and the firm performing the review are members of the same *association*, as that term is used in SECPS §3000, "Guidelines for Involvement by Associations of CPA Firms", then they must adhere to the additional requirements contained in that section. SECPS §3000.02 defines an association as any association, network, or alliance of accounting firms. The term also applies to two or more firms or a group of firms (whether a formal or informal group) that jointly market or sell services.



## 2014 Standards for Performing and Reporting on Peer Reviews

### **Capability**

- .37 A reviewing firm must determine its capability to perform a peer review. The reviewing firm must have available to it reviewers with appropriate levels of expertise and experience to perform the review. Before accepting an engagement, the reviewing firm should obtain information about the firm to be reviewed, including certain operating statistics concerning size and practice.
- .38 In determining its capability to perform the review, the reviewing firm should consider the size of the firm to be reviewed in relation to its own size. A reviewing firm must recognize that the performance of a peer review may demand substantial commitments of time, especially from its supervisory accounting and auditing personnel. Therefore, a firm should consider carefully the number and availability of supervisory personnel in determining whether it can perform a peer review of another firm.

### **Correspondent Firms**

- .39 Occasionally, a reviewing firm may use a correspondent member firm to perform part of a peer review. In such cases, the principal reviewing firm must (a) be satisfied with respect to the independence and capability of the correspondent, (b) assume responsibility for the work performed by the correspondent, (c) adopt appropriate measures to ensure the coordination of its activities with the correspondent, and (d) plan to satisfy itself with respect to the work performed by the correspondent. The report on the review should not refer to a correspondent firm's participation in the review. To determine its capability to perform its portion of a peer review, a correspondent member firm should also consider the requirements discussed herein before accepting an engagement.

### **The Review**

#### **Definitions**

- .40 Just as the performance of an audit entails audit risk, the performance of a peer review includes peer review risk. Peer review risk is the risk that the review team-
- a. Fails to identify significant weaknesses in the reviewed firm's system of quality control for its accounting and auditing practice, its compliance with that system or with the Section's membership requirements, or both.

- b. Issues an inappropriate opinion on the reviewed firm's system of quality control for its accounting and auditing practice, its compliance with that system or with the Section's membership requirements, or both.
  - c. Reaches an inappropriate decision about the findings to be included in or excluded from the letter of comments, or about whether to issue a letter of comments.
- .41 Peer review risk consists of the following two parts:
- a. The risk (consisting of inherent risk<sup>12</sup> and control risk<sup>13</sup>) that an engagement will fail to comply with professional standards or that the reviewed firm's system of quality control will not prevent such failure, or both.
  - b. The risk (detection risk) that the review team will fail to detect the design or compliance deficiencies in the reviewed firm's system of quality control that either result in the firm having less than reasonable assurance of conforming with professional standards or constitute conditions whereby there is more than a remote possibility that the firm will not conform with professional standards on accounting and auditing engagements.
- .42 Inherent risk and control risk relate to the reviewed firm's accounting and auditing practice and its system of quality control and are 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

---

<sup>12</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>13</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 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 to establish, enhance, or mitigate 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.

## 2016 Standards for Performing and Reporting on Peer Reviews

risks is qualitative and not quantitative.

### General Considerations

.43 The review should include the following procedures:

a. Planning the review:

1. Obtain a sufficient understanding of the nature and extent of the firm's accounting and auditing practice to plan the review.
2. Obtain a sufficient understanding of the design of the firm's system of quality control to plan the review.
3. Obtain a sufficient understanding of the effectiveness of the monitoring procedures<sup>14</sup> since the last peer review to plan the review.
4. Assess inherent risk and control risk (including determining whether the firm's inspection procedures for the current year are likely to enable the review team to reduce the number of offices or engagements to be reviewed or the extent of the functional area reviews, and, if so, perform tests of the findings and conclusions of the current year's inspection procedures).
5. Use the knowledge obtained from the foregoing to select the offices and the engagements to be reviewed, and to determine the nature and extent of the tests to be applied in the functional areas.

b. Performing the review

1. Review compliance with the reviewed firm's system of quality control at each organizational or functional level within the firm.
2. Review selected engagements, including the relevant working paper files and reports.
3. Review compliance with the membership requirements of

---

<sup>14</sup> See Statement on Quality Control Standards (SQCS) No. 3, *Monitoring a CPA Firm's Accounting and Auditing Practice*, (AICPA, Professional Standards, vol.2, QC sec. 30.08).

the Section.

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 the team captain to discuss the review team's findings and recommendations and the type of report it will issue.
6. Prepare a written report on the results of the review and, if applicable, a letter of comments.

#### **Scope of the Review**

- .44 The scope of the review should cover a firm's accounting and auditing practice. Other segments of a firm's practice, such as tax services or management advisory services, are not encompassed by the scope of the review except (a) to the extent they are associated with the firm's accounting and auditing practice (for example, reviews of tax provisions and accruals contained in financial statements are included in the scope of the review) or (b) as they relate to compliance with membership requirements of the Section firm in connection with the review.
- .45 The review will be directed to the professional aspects of the reviewed firm's accounting and auditing practice; it will not include the business aspects of that practice. It may be difficult to distinguish between these aspects of the practice, as overlap may occur. For example, in evaluating whether the supervision of an engagement was adequate, review team members would consider budgeted and actual time spent on the engagement by various categories or classifications of personnel but would not inquire as to fees billed to the client or the relationship of fees billed to time accumulated at usual or standard billing rates.
- .46 Further, when reviewing policies and procedures for personnel management, review team members would concern themselves with whether professional personnel were promoted on the basis of demonstrated competence and whether criteria for admission of individuals to the firm give appropriate weight to professional qualifications, but would not review compensation of professional personnel.
- .47 The review should cover a current period of one year, to be mutually agreed upon by the reviewed firm and the review team

## **2018 Standards for Performing and Reporting on Peer Reviews**

captain. (See Appendix B, SECPS §2000.143.) It is anticipated that the system of quality control may be revised, updated, or amended during the period under review to recognize changing conditions, new professional standards, or new membership requirements. The scope of the review should encompass the system of quality control in effect and compliance therewith for the year under review.

- .48 Client engagements subject to selection for review ordinarily should be those with periods ending during the year under review unless a more recent report has been issued at the time the engagement is reviewed.
- .49 The review should be concerned with the accounting and auditing engagements performed by the U.S. offices of the reviewed firm selected for review and the supervision and control, in accordance with U.S. professional standards, of work on segments of such engagements performed by foreign offices or by domestic or foreign affiliates or correspondents. (See Appendix C, SECPS §2000.144.) The reviews of engagements should usually be directed toward the accounting and auditing work performed by the practice offices visited, including work performed for another office of the reviewed firm, for a correspondent firm, or for an affiliated firm. For those situations in which engagements selected in the practice office 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.

### ***Acquisition and Divestment***

- .50 When a reviewed firm has had a significant acquisition of another practice or a portion thereof, or a divestment of a significant portion of its practice, during or subsequent to its review year, the reviewer, the reviewed firm, or both should consult with the Committee or its staff before the review begins to consider the appropriate scope of the review or other actions that should be taken so that the peer review report will not have to be modified for a scope limitation.

### ***Restriction of Scope***

- .51 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. If the team is not satisfied with the explanation, the matter should be reported to the reviewed firm's managing partner, and the review team should consider what other action, if any, may be appropriate in the circumstances. If the review team concludes that the engagements excluded from the review process do not materially affect the review coverage, then the review team ordinarily would conclude that the scope of the review had not been unduly restricted. To reach such a conclusion, 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 and other work of the supervisory personnel who participated in the excluded engagements.

**Obtain an Understanding of the Nature and Extent of the Accounting and Auditing Practice**

- .52 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 ordinarily is obtained through such procedures as reading the reviewed firm's annual report filed with the Section, inquiries of appropriate management personnel, and requests of management to provide specific background information, some of which will have been provided to the review team before the review was accepted. The statistical information may be approximate amounts or estimates.
- .53 The following are examples of the background information that may be obtained from the reviewed firm:
- a. A description of the firm's organization (an organization chart may be useful).
  - b. The firm's philosophy, including such matters as- <sup>15</sup>

---

<sup>15</sup> See also Appendix H to SECPS §1000.42, "Illustrative Statement of Firm Philosophy."

## 2020 Standards for Performing and Reporting on Peer Reviews

1. The firm's goals or objectives.
  2. Operating practices regarding service to clients and development of personnel.
  3. Policies relating to industry specialization or practice specialists.
  4. Operating autonomy of regional and practice offices or other meaningful segments or breakouts of the firm's practice (the extent of decentralization of authority).
- c. The firm's profile, consisting of-
1. The number of accounting and auditing hours (If such an analysis is not available, the reviewed firm may analyze total billings by function or make an estimate of the percentage of accounting and auditing work.)
  2. The number of accounting and auditing clients (including hours), classified by audits, reviews, and compilations, and by type-publicly held, privately held, governmental, not-for-profit, FDIC Improvement Act of 1991 (FDICIA), and Employee Retirement Income Security Act (ERISA).
  3. Industry concentrations and specialty practice areas, such as SEC or regulated industries.
  4. The number of SEC audit clients, each of whose total domestic fees exceeds 5 percent of total domestic firm fees, and the percentage that each of these clients' fees represent to total domestic firm fees.
  5. The names of SEC audit clients<sup>16</sup> accepted since the end of the last peer review year (or for the year under review if the reviewed firm has not previously had a peer review), where, as reported in a Form 8-K, in a similar public filing, such as a document filed with the Office of the Comptroller of the Currency (OCC), the Federal Reserve Board (FRB), or the Federal Deposit Insurance Corporation (FDIC), or in a document filed with the Office of Thrift Supervision (OTS) that is

---

<sup>16</sup> As defined in parts one and two of Appendix D, SECPS §1000.38, "Definition of an SEC Engagement."

available to the successor auditor, the former accountant resigned (or declined to stand for reelection) or there was a reported disagreement over any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, or there was a "reportable event" as defined in item 304(a)(1)(v) of SEC Regulation S-K.

6. The names of SEC registrants<sup>17</sup> (a) for which there was a predecessor accountant or auditor and (b) for which the reviewed firm's first report on accounting and auditing services related to a period that ended during the reviewed firm's peer review year.
7. The number of professional accounting and auditing personnel, analyzed by level.
8. The extent of use of correspondent firms on engagements.
9. Descriptions of mergers, demergers, or divestments since the last peer review.
10. Newly opened offices.

(If the reviewed firm is a multi-office firm, information should be broken out by individual practice offices. Offices that are part of a larger practice unit may be grouped together.)

- d. Litigation, proceedings, or investigations against the firm or its personnel reported to the Quality Control Inquiry Committee since the date of the firm's last peer review.

#### **Obtain an Understanding of the Design of the System of Quality Control**

- .54 Statement on Quality Control Standards (SQCS) No. 2, System of Quality Control for a CPA Firm's Accounting and Auditing Practice (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 states that the quality control policies and procedures applicable to its accounting and auditing practice should encompass the following elements: independence,

---

<sup>17</sup> As defined in part one of Appendix D, SECPS §1000.38, "Definition of an SEC Engagement."



## 2022 Standards for Performing and Reporting on Peer Reviews

integrity, and objectivity; personnel management; acceptance and continuance of clients and engagements; engagement performance; and monitoring. In planning the review, 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. The understanding should include knowledge about the design of the reviewed firm's quality control policies and procedures that have been established to ensure that the system of quality control has been designed to meet the requirements of the quality control standards established by the AICPA.

### ***Obtain an Understanding of the Effectiveness of the Monitoring Procedures Performed Since the Last Peer Review***

#### **Obtain an Understanding of the Reviewed Firm's Monitoring Policies and Procedures**

- .55 The review team should obtain an understanding of the reviewed firm's policies and procedures for accomplishing the objectives of monitoring when it obtains an understanding of the design of the reviewed firm's system of quality control (see the preceding paragraph).

#### **Obtain an Understanding of the Effectiveness of the Monitoring Procedures Performed**

- .56 The review team should obtain a sufficient understanding of the effectiveness of the firm's monitoring procedures since its last peer review to plan the current peer review. Factors to consider in obtaining the understanding include:
- a. The qualifications of personnel performing the monitoring procedures.
  - b. The scope of the monitoring procedures (coverage of functional areas and engagements and the criteria for selecting offices and engagements for review).
  - c. The sufficiency of the materials used for monitoring procedures (for example, questionnaires or checklists and instructions).
  - d. The depth of the review of individual engagements, particularly with respect to the review of working papers and coverage of key areas.
  - e. The findings of the monitoring procedures.

- f. The nature and extent of reporting and communicating the results of the monitoring procedures.
- g. The follow-up of findings resulting from the monitoring procedures.

**Assess Inherent and Control Risk**

- .57 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 inherent and control risks. (See footnotes 12 and 13 on page 2015 for definitions of these risks.) After assessing these risks and the effects of the current year's inspection procedures on the current peer review, the review team should determine the level of detection risk it may appropriately assume and the offices and engagements to be reviewed so that it can reduce peer review risk to an acceptable low level.
- .58 Assessing inherent risk is the process of evaluating the likelihood that the reviewed firm will perform engagements that do not conform with professional standards in the absence of a system of quality control. Assessing control risk is the process of evaluating the effectiveness of the reviewed firm's system of quality control in preventing the performance of engagements that do not comply with professional standards. (Inherent and control risks may be assessed separately or together.)
- .59 The assessed level of inherent risk may be affected by circumstances arising (a) within the firm (for example, individual partners 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 (b) outside the firm that affect its clients (for example, new professional standards being applied for the first time, changes in regulatory requirements, or adverse economic developments in an industry). The assessed level of inherent risk may vary from engagement to engagement (for example, it ordinarily would be greater for an initial public offering than for a nondisclosure compilation of a small privately owned entity.)
- .60 When assessing control risk, the review team should evaluate the reviewed firm's system of quality control 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 comprehensive and

## 2024 Standards for Performing and Reporting on Peer Reviews

suitably designed policies and procedures that are relevant to the size and nature of its practice. When making the evaluation, the review team may wish to consult the guidance provided in the *Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice*.

### Determine the Effects of the Current Year's Inspection Procedures on the Peer Review

- .61 After obtaining an understanding of the reviewed firm's monitoring policies and procedures and the potential effectiveness of its monitoring procedures, the review team should determine whether the current year's inspection procedures are likely to enable the review team to reduce, in a cost-beneficial manner, the number of offices and engagements selected for review or the extent of the functional area reviews. In making a judgment about the effects that the firm's current year's inspection procedures will have on the selection of offices and engagements to be reviewed, the review team should consider the size of the firm and the potential effectiveness of the inspection procedures. (If inspection procedures were not, or will not be, performed to cover the review year, the review team may not consider the prior year's inspection procedures to reduce the scope of the peer review.)
- .62 If the review team does not plan to consider the reviewed firm's current year's inspection procedures to reduce the scope of the peer review, the review team need not necessarily perform the review of any of the engagements on which inspection procedures were performed by the reviewed firm. However, the review team may still wish to reperform the review of a few such engagements to assist the review team in obtaining a better understanding of the effectiveness of the inspection procedures performed by the reviewed firm.

### Test the Effectiveness of the Current Year's Inspection Procedures

- .63 If the review team plans to consider the current year's inspection procedures to reduce the scope of the peer review, the review team should test the firm's inspection procedures at selected offices and on selected engagements. These tests should be sufficient to provide the review team with a basis for determining whether (a) the reviewed firm's inspection procedures were applied properly in the reviews of individual practice offices and engagements, (b) the practice office and engagement reviews were carried out conscientiously by competent persons with appropriate expertise and objectivity,

and (c) the findings from the reviewed firm's inspection procedures are indicative of the work performed in the particular office and therefore can be considered by the review team to reach an overall conclusion regarding the reviewed firm's compliance with its quality control policies and procedures.

- .64 The testing of inspection procedures can be performed (a) contemporaneously with the reviewed firm's inspection procedures (commonly called "piggyback reviews") or (b) after the inspection procedures are completed. Because of the insight gained from observing the performance of inspection procedures, a review team testing the effectiveness of inspection procedures contemporaneously is generally in a better position to assess the effectiveness of the procedures.
- .65 When the review team tests the effectiveness of the inspection procedures contemporaneously with the performance by the inspection team performing the procedures, the review team should visit selected practice offices during the performance of the inspection procedures to (a) reperform the review of a sample of engagements subjected to inspection procedures and (b) reperform the review of a sample of the quality control policies and procedures (functional elements) subjected to inspection procedures in the office. During the visits, the review team should compare its findings to the inspection team's findings and resolve any differences. In addition, if applicable, the review team should attend discussions of engagement findings and the overall office findings.
- .66 When the review team tests the effectiveness of the inspection procedures after the procedures have been completed, the review team should reperform the review of a sample of engagements and the quality control policies and procedures (functional elements) subjected to inspection procedures in the office(s). The review team should compare its findings to the inspection team's findings and resolve any differences.

#### ***Select Offices and Engagements for Review***

- .67 The number and type of accounting and auditing engagements reviewed, when combined with the results of the firm's inspection procedures, should be sufficient to provide the review team with a reasonable basis for its conclusions about the reviewed firm's system of quality control.

#### **Relationship of Risk to Scope**

- .68 The review team should consider the combined assessed levels

## 2026 Standards for Performing and Reporting on Peer Reviews

of inherent and control risk when selecting offices and engagements to be reviewed. The higher the combined assessed levels of inherent and control risk, the greater the scope (that is, the greater the number of offices that should be visited, the greater the number of engagements that should be reviewed, or both). Conversely, the lower the combined assessed levels of inherent and control risk, the less the scope that needs to be considered for review. The combined assessed levels of inherent and control risk may vary among offices and engagements so that the scope may be greater for some types of offices and engagements than for others.

- .69 When the combined assessed levels of inherent and control risk are considered to be low, a relatively small number of engagements may be selected for review. However, even when the combined assessed levels are low, the peer review team must review some engagements to obtain reasonable assurance that the reviewed firm is complying with its quality control policies and procedures and professional standards. For the review team to obtain such assurance, a reasonable cross section of the reviewed firm's accounting and auditing engagements must have been reviewed or inspected, with greater emphasis on those portions of the practice with higher combined assessed levels of inherent and control risk.

### Relationship of Inspection Procedures to Scope

- .70 If, because of the effectiveness of the reviewed firm's current year's inspection procedures, the review team intends to reduce the scope of the peer review, the review team should consider the reviewed firm's basis for selecting offices and engagements for inspection procedures when determining the offices and engagements the review team will review. The selection of offices and engagements for the peer review should complement the selection for the current year's inspection procedures. For example, if the reviewed firm's selection of offices and engagements for inspection procedures is weighted more toward obtaining a reasonable cross section of its accounting and auditing practice (for example, coverage of all partners and offices every three years), then the review team should place greater weight on selecting offices and engagements with higher combined assessed levels of inherent and control risk.
- .71 If the review team does not intend to consider the reviewed firm's current year's inspection procedures to reduce the scope of the peer review, the review team's selection of offices and engagements for review should cover a reasonable cross section of the reviewed firm's accounting and auditing

practice, with greater emphasis on those offices and engagements in which the combined levels of inherent and control risk are higher.

#### Other Matters to Consider

- .72 The review team should consider whether litigation, proceedings, or investigations against the firm or its personnel, including those that were (or should have been) reported to the Quality Control Inquiry Committee since the date of the firm's last peer review, exhibited any patterns regarding the offices, industries, audit areas, or engagement personnel involved, and whether the firm has considered any such patterns in the scope of its own inspection procedures or other internal review programs. By giving due regard to the fact that such litigation, proceedings, and investigations will ordinarily involve unproved allegations, the review team should consider this information in setting the scope of the review and in selecting the offices and engagements to be reviewed.
- .73 The review team should obtain the reviewed firm's latest peer review report, and, if applicable, its letter of comments and response thereto, from the firm or from the AICPA Practice Monitoring Department and should consider whether matters discussed in the documents require additional emphasis in the current review. In all cases, the review team should evaluate the actions taken by the reviewed firm in response to the last report and letter of comments.
- .74 The combined assessed levels of inherent and control risk, and thus the scope of the peer review, may need to be revised during the performance of the review if the results of the engagement and functional area reviews warrant such revision.
- .75 For a multi-office firm, the review should include visits to the firm's executive office and, if applicable, selected regional and practice offices.

#### **Special Engagement Selection Considerations**

- .76 Because a primary objective of the SEC Practice Section is to improve the quality of practice by CPA firms before the SEC, greater weight should be given to selecting engagements defined as SEC engagements in Appendix D (§1000.38) to the *Organizational Structure and Functions of the SEC Practice Section of the AICPA Division for CPA Firms*.
- .77 After selecting the engagements to be reviewed based on the

## 2028 Standards for Performing and Reporting on Peer Reviews

risk assessment, the review team should ensure that the scope of the review includes, at minimum, when applicable-

- a. At least one SEC engagement for which the fees for management advisory services exceeded the audit fees.
- b. All SEC engagements<sup>18</sup> accepted since the end of the last peer review year (or for the year under review if the reviewed firm has not previously had a peer review), where, as reported in a Form 8-K or in a similar public filing, such as a document filed with the OCC, the FRB, or the FDIC, or, in a document filed with the OTS that is available to the successor auditor, the former accountant resigned (or declined to stand for reelection) or there was a reported disagreement over any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, or there was a "reportable event" as defined in item 304(a)(1)(v) of SEC Regulation S-K. For such engagements, the review team should-
  1. Review the existing client acceptance documentation that relates to the matters or procedures that were the subject of the resignation or disagreement or reportable event.
  2. Review such current or prior periods' engagement working papers, financial statements, or auditor's reports to the extent considered necessary to evaluate whether the matters or procedures were handled appropriately.
  3. Determine whether, since the end of the last peer review (or for the year under review if the firm has not previously had a peer review) any opinions on the application of generally accepted accounting principles were rendered to the entity prior to acceptance.
  4. Determine whether any such opinion was issued pursuant to the firm's policies relating to the issuance of such opinions.
- c. At least one SEC engagement<sup>19</sup> in each office reviewed (1)

---

<sup>18</sup> As defined in parts one and two of Appendix D, SECPS §1000.38, "Definition of an SEC Engagement".

<sup>19</sup> As defined in parts one and two of Appendix D, SECPS §1000.38, "Definition of an SEC Engagement."

for which there was a predecessor accountant or auditor and (2) for which the reviewed firm's first report on accounting and auditing services related to a period that ended during the reviewed firm's peer review year. In addition, for all such engagements in the offices reviewed, the review team should review the existing client acceptance documentation and, based on the results of the review, consider the need to select additional engagements (or portions of engagements) for review, particularly in circumstances in which the prior accountant's or auditor's most recent audit report was qualified or contained explanatory language not relating to consistency or the report of another auditor. Furthermore, if there are any engagements in the offices selected that meet the criteria in this paragraph and in paragraph 76b, those engagements (or portions of those engagements) should be reviewed.

- d. At least one engagement performed during the peer review year or subsequently in connection with a filing under the Securities Act of 1933. The term engagement as used in this context—in connection with a Securities Act of 1933 filing includes subsequent events procedures performed during the peer review year or subsequently through the effective date of a registration statement, even though the firm may not have performed an audit of the entity during the peer review year or subsequently.
- e. At least one multi-office engagement. For such engagement(s), the work performed by the office with primary responsibility for the engagement and by at least one domestic office that performed the work on a significant segment of the engagement should be reviewed. If the participating office is not selected for a visit, the review can be accomplished by having the appropriate working papers sent to the primary office being visited. The engagement(s) selected should include an adequate sample of work performed by practice offices visited for other offices of the reviewed firm so that the application of the firm's specific quality control policies and procedures for such work can be appropriately tested.
- f. At least one engagement subject to the *Government Auditing Standards* if the peer review is intended to meet the requirements of those standards.
- g. At least one federally issued depository institution engagement with more than \$500 million in total assets subject to section 36 of the *Federal Deposit Insurance Act* if the peer review is intended to meet the requirements of



## 2030 Standards for Performing and Reporting on Peer Reviews

that Act established by the *Federal Deposit Insurance Corporation Improvement Act of 1991*.<sup>20</sup>

- h. At least one engagement subject to the *Employee Retirement Income Security Act of 1974 (ERISA)* if the firm intends to continue to perform audits pursuant to that Act.

### **Reasonableness of Scope**

- .78 The time required to review individual engagements will vary depending on the size, nature, and complexity of the engagements. Review time in proportion to total engagement hours may be greater for small engagements than for large engagements. See Appendix D, *Selecting Engagements for Review*, herein (§2000.145) for a discussion of ways to achieve appropriate coverage of engagements without devoting unnecessary time to the review.
- .79 If the review team believes that the offices or engagements selected for review by applying the standards in this section do not result in a reasonable scope, the review team should consider consulting with the Committee or its staff.

### **Documentation of Planning**

- .80 The review team should document planning procedures as they are performed to permit the Committee or its staff and the Public Oversight Board or its staff to review them contemporaneously with the performance of the review if they elect to do so. Such documentation should demonstrate that-
  - a. Appropriate judgment was exercised when assessing the inherent and control risks associated with the reviewed firm's accounting and auditing practice and its system of quality control.
  - b. Appropriate consideration was given to the combined assessed levels of inherent and control risk and the firm's current year's inspection procedures (when considered to reduce scope), and also other selection considerations, when selecting offices and engagements to be reviewed.

---

<sup>20</sup> In the audit of federally insured depository institutions with \$500 million or more in total assets, the independent auditor may issue reports on internal control. The peer review standards contemplate that such reports issued in connection with a financial statement audit will be included in the scope of the peer review if the audit is selected for review.

- c. The offices and engagements to be reviewed, inspected, or both cover a reasonable cross section of the firm's accounting and auditing practice, with greater emphasis on offices and engagements that contribute to a higher assessed level of inherent and control risk to the firm.
- .81 The risk assessment should be documented in the summary review memorandum described in the section of these peer review standards titled "*Review Team Working Papers*". Because of the number of factors to be considered and the complexities of the judgments to be made, such documentation should be comprehensive and may be provided as an appendix to the summary review memorandum.

#### ***Extent of Compliance Tests***

- .82 Based on its planning, the review team should develop programs to test compliance with the system.<sup>21</sup> In doing so, the review team should consider whether any modifications are necessary to the programs and checklists issued by the Committee. The compliance tests should be tailored to the practice of the firm under review and should be sufficiently comprehensive to provide a reasonable basis for concluding whether the reviewed firm's quality control policies and procedures were complied with to provide the firm with reasonable assurance of conforming with professional standards in the conduct of its accounting and auditing practice. Such compliance tests should be performed at the practice office(s) selected for review, on a firm-wide and on an individual engagement basis. The tests may include-
- a. Reviewing selected engagements, including working paper files and reports and interviewing engagement personnel, to evaluate whether the engagements conformed with professional standards and complied with the firm's policies and procedures for *Engagement Performance* and other relevant elements of quality control.
- 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.

---

<sup>21</sup> Instructions, checklists, and programs are included in the SEC Practice Section Peer Review Program Manual and should be considered for their applicability.

## 2032 Standards for Performing and Reporting on Peer Reviews

- c. Reviewing evidential matter to determine whether the firm has complied with its policies and procedures for the quality control element of *Monitoring*, for example, reviewing inspection reports (if inspection procedures have been performed) as well as communications to firm personnel that discuss changes in the firm's quality control policies and procedures or the need to improve compliance and documentation in the areas relating to those changes.
- d. Reviewing other evidential matter, as appropriate, for compliance with the firm's quality control policies and procedures relating to the *Independence, Integrity, and Objectivity, Personnel Management, and Acceptance and Continuance of Clients and Engagements* elements of quality control, for example, reviewing selected administrative or personnel files, correspondence files documenting consultations on ethical questions, files evidencing compliance with professional development requirements, and the firm's library.
- e. Reviewing evidential matter to determine whether the firm has complied with the membership requirements of the Section, for example, reviewing compliance with continuing professional education (CPE) requirements, the concurring partner review requirement on SEC engagements, and the five-day notification requirement on termination of SEC clients.

### **Location of Documentation**

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

### **Extent of Engagement Review**

- .84 The objectives of the review of engagements are to obtain evidence of the following: (a) whether the reviewed firm's system of quality control for its accounting and auditing practice was designed to meet the requirements of the quality

control standards established by the AICPA to the extent that such requirements are applicable to its practice; (b) whether the reviewed firm complied with the policies and procedures that constituted its system of quality control during the year under review; and (c) whether the reviewed firm complied in all material respects with the applicable membership requirements of the Section during the year under review. To the extent necessary to achieve these objectives, the review of engagements should include review of financial statements, reports, working papers, and correspondence and discussions with professional personnel of the reviewed firm. The depth of review of working papers for particular engagements is left to the judgment of the reviewers. However, the review should ordinarily include all key areas of an engagement 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.

- .85 For each engagement reviewed, the review team must evaluate and document, based on its review of the engagement working papers and representations from reviewed firm personnel, whether anything came to the review team's attention that caused it to believe that (a) the financial statements were not presented in all material respects in accordance with generally accepted accounting principles or, if applicable, an other comprehensive basis of accounting, (b) the firm did not have a reasonable basis under the applicable professional standards for the report issued, (c) the documentation on the engagement did not support the report issued, or (d) the firm did not comply with its quality control policies and procedures in all material respects.<sup>22</sup>
- .86 In performing engagement reviews, the review team may encounter: (a) indications of significant failures by the reviewed firm to reach appropriate conclusions in the application of professional standards, which include generally accepted auditing standards, governmental auditing standards, standards for accounting and review services, attestation standards, and generally accepted accounting principles (for example, the reviewed firm may have issued an inappropriate report on a client's financial statements or omitted a necessary auditing procedure), or (b) situations in which the documentation on the engagement does not support the report issued. In either case, the team captain should promptly

---

<sup>22</sup> See the conclusions section of the engagement checklist contained in the SEC Practice Section Peer Review Program Manual.

## 2034 Standards for Performing and Reporting on Peer Reviews

inform an appropriate authority in the reviewed firm (generally on a "Matter for Further Consideration" form). In such circumstances, the reviewed firm should investigate the matter questioned by the review team and determine what action, if any, should be taken.<sup>23</sup> The reviewed firm should advise the review team 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 review team).

- .87 If the reviewed firm believes, after investigating the matter, that it can continue to support its previously issued report, it should provide the review team with a written explanation of the basis for its conclusion (generally on a "Matter for Further Consideration" form). If the explanation appears reasonable, the review team should consider whether the documentation on the engagement supports the report issued. In evaluating the responses, the review team should recognize that the reviewed firm has not made an examination of the financial statements in accordance with generally accepted auditing standards (or reviewed or compiled them in accordance with the standards for accounting and review services) or performed the engagement in accordance with the attestation standards, and that it has not had the benefit of access to the client's records, discussions with the client, or specific knowledge of the client's business.
- .88 After reviewing the documentation supporting the actions planned or the documentation explaining why no action is required, the review team may continue to question whether there is a significant failure to reach appropriate

---

<sup>23</sup> Under generally accepted auditing standards and the standards for accounting and review services, the reviewed firm is required to take appropriate action in certain circumstances with respect to (a) subsequently discovered information that relates to a previously issued report or (b) the omission of one or more procedures considered necessary to support a previously expressed opinion. See Statement on Auditing Standards (SAS) No. 1 (AICPA, Professional Standards, vol. 1, AU sec. 561), SAS No. 46, *Consideration of Omitted Procedures After the Report Date* (AICPA, Professional Standards, vol. 1, AU sec. 390), and Statement on Standards for Accounting and Review Services (SSARS) 1, *Compilation and Review of Financial Statements* (AICPA, Professional Standards, vol. 2, AR sec. 100.42, "Subsequent Discovery of Facts Existing at Date of Report").

conclusions in the application of professional standards. In such cases, the review team should promptly inform an appropriate authority in the reviewed firm and pursue any remaining questions. At this time, the reviewed firm should also be made aware that any unresolved issues will be referred promptly to the SECPS Peer Review Committee for resolution.

- .89 If, after having considered the reviewed firm's views in support of its position, a majority of the SECPS Peer Review Committee members eligible to vote on matters related to that peer review disagree with the reviewed firm, the firm shall have fifteen days to advise the Committee that it (a) accepts the Committee's decision and agrees to describe the actions it has taken to implement that decision, or (b) agrees to the appointment of an arbitration panel by the chair of the AICPA Professional Ethics Executive Committee to consider the disagreement related to the review, agrees to comply with the conclusions of that panel, and agrees to advise the SECPS Peer Review Committee of the actions required.
- .90 When the reviewed firm concludes there is a significant failure to reach an appropriate conclusion on the application of professional standards on an engagement, the review team should review the firm's plan for addressing the questioned matter and document in the summary review memorandum whether the plan appears appropriate in the circumstances. If those actions are taken before the issuance of the peer review report (for example, the report and financial statements are reissued, omitted auditing procedures are performed, or a previously issued report is recalled), the review team should review the documentation supporting such actions. If the actions are not taken before the issuance of the report, the review team should advise the reviewed firm that it may be asked by the Committee to allow the reviewer to review the documentation supporting such actions when those actions are completed.

#### ***Expansion of Scope***

- .91 If, during the peer review, the reviewed firm concludes that there was a significant failure to reach an appropriate conclusion on the application of professional standards on one or more of its engagements, the review team should consider whether the application of additional review procedures is necessary. This consideration should be documented in the peer review working papers. The objective of the application of additional procedures would be to determine whether the significant failure is indicative of a pattern of such failures, whether it is a significant weakness in the reviewed

## 2036 Standards for Performing and Reporting on Peer Reviews

firm's system of quality control or in its compliance with the system, or whether it is both. In some circumstances, the reviewer may conclude that, because of compensating controls, or for other reasons, further procedures are unnecessary. If, however, additional procedures are deemed necessary, they may include an expansion of scope to review all or relevant portions of one or more additional engagements. Such additional engagements may be in the same industry, or supervised by the same individual in the reviewed firm, or otherwise have characteristics associated with the failure to apply professional standards.

### **Completion of the Review**

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

### **REVIEW TEAM WORKING PAPERS**

- .94 Working papers must be prepared by the review team to document the work performed and the findings and conclusions. To

facilitate summarization of the review team's findings and conclusions, the team captain should instruct the review team concerning the manner in which working papers, programs, and checklists are to be prepared. Working papers and engagement review checklists should not identify the reviewed firm's clients.

- .95 During the peer review, the review team should continue to evaluate the firm's system of quality control and its compliance therewith. "Matter for Further Consideration" forms should be prepared for matters that could indicate that one or more of the firm's policies and procedures had not been designed to meet the requirements of the quality control standards established by the AICPA, or that the reviewed firm did not comply with professional standards, the policies and procedures that constitute its system of quality control, or a membership requirement. The review team should conclude on the implications, for the system, of the matters identified on the "Matter for Further Consideration" forms and indicate their disposition. (The factors the review team should consider in evaluating the instances of noncompliance and deficiencies in the design of the firm's system of quality control are described more fully under "Reporting Considerations", §SECPS 2000.103-.113, and "Letter of Comments", SECPS §2000.114-.119.)
- .96 At the conclusion of fieldwork, the review team should do the following: (a) summarize all of their findings (including answers to the individual engagement checklists and "Matter for Further Consideration" forms); (b) compare the findings of the current year's inspection procedures, if any, with the peer review findings and be satisfied regarding the causes and validity of any differences as part of its assessment of the effectiveness of the firm's inspection procedures; (c) evaluate the nature, causes, pattern, pervasiveness, and significance of the deficiencies noted in the design of the firm's system of quality control and in the firm's compliance with its system, with professional standards, and with the membership requirements of the Section; and (d) consider whether such matters should result in a modified report, be included in the letter of comments, or otherwise be communicated to the firm. The summary also assists the review team captain in preparing an overall summary review memorandum. Such a memorandum should cover (a) the planning of the review, (b) the scope of work performed, and (c) the findings and conclusions to support the report and the letter of comments issued. It should also include comments communicated to senior management of the reviewed firm that were not deemed of sufficient significance to be included in



## 2038 Standards for Performing and Reporting on Peer Reviews

the letter of comments. In a review of a multi-office firm, similar procedures would be followed for each office reviewed. (See exhibit A, SECPS §2000.136, and exhibit B, SECPS §2000.137.)

97. All working papers, reports, and letters prepared during an SECPS peer review should be retained after the report has been issued, only for the time specified by the Section, to permit oversight of this part of the review process.<sup>24</sup> The Committee and its staff may extend this period on individual reviews when it believes that it may need to refer to such working papers to carry out its responsibilities.

### REPORTING ON PEER REVIEWS

#### The Review Team's Report

- .98 Within thirty days of the date of the exit conference the review team should furnish the reviewed firm and the Section with a written report and, if applicable, a letter of comments.
- .99 The report and letter of comments should be addressed to the partners, proprietors, stockholders, or officers of the reviewed firm and should be dated as of the date of the exit conference.
- .100 A report by a review team from a member firm should be issued on the reviewing firm's letterhead and signed in the firm's name. All other reports are to be issued on the letterhead of the entity that appointed or formed the review team and should be signed by the review team captain for the review team (without reference to the captain's firm).
- .101 The team captain should notify the Section when the review has been completed and the report and letter of comments have been issued. If no letter of comments was issued, the notification should so state.
- .102 The reviewed firm should submit a copy of the report, the letter of comments, if any, and its response to all matters discussed in the report or letter of comments to the Section within fifteen days of the date the report and letter of comments are issued. (See Appendix G, SECPS §1000.41).

---

<sup>24</sup> See "Retention Period" under "Review Team Working Papers", SECPS §5000.26-.29.

- .103 The reviewed firm should not publicize the results of the review or distribute copies of the report to its personnel, its clients, or others until it has been advised that the Committee has accepted the report.

**Reporting Considerations**

- .104 The report should contain-

- a. A statement of the scope of the review, including any limitations thereon.
- b. A description of the general characteristics of a system of quality control for an accounting and auditing practice.
- c. A reference to the letter of comments, if such a letter was issued.
- d. The review team's opinion on whether the reviewed firm's system of quality control has been designed to meet the requirements of the quality control standards for an accounting and auditing practice established by the AICPA, and whether it was being complied with during the year reviewed to provide the firm with reasonable assurance of conforming with professional standards, and, if not, a description of the reasons for the modification.
- e. The review team's opinion on whether the reviewed firm complied with the membership requirements of the Section in all material respects, and, if not, a description of the reasons for the modification.

- .105 A review team may issue a modified or an unmodified report.<sup>25</sup> (See SECPS §2100, "Guidelines for and Illustrations of Peer Review Reports.") In deciding the type of opinion to be issued, a review team should consider the evidence it has obtained and form three overall conclusions with respect to the year being reviewed:

- a. Whether the policies and procedures that constitute the reviewed firm's system of quality control for its accounting and auditing practice have been designed to meet the requirements of the quality control standards established by the AICPA to provide the firm with reasonable assurance of conforming with professional

---

<sup>25</sup> The term **modified report** includes a modified or an adverse opinion.

## 2040 Standards for Performing and Reporting on Peer Reviews

standards.

- b. Whether personnel of the reviewed firm complied with such policies and procedures in order to provide the firm with reasonable assurance of conforming with professional standards.
  - c. Whether the reviewed firm complied with the membership requirements of the Section in all material respects.
- .106 To give appropriate consideration to the evidence obtained and to form the appropriate conclusions, the review team must understand the elements of quality control and exercise professional judgment. The exercise of professional judgment is essential because the significance of the evidence obtained cannot be evaluated primarily on a quantitative basis.

### ***Design Deficiencies***

- .107 Use of professional judgment is especially essential in formulating the first conclusion previously described. In forming this conclusion, the review team should consider the significance of any design deficiencies noted in the reviewed firm's system of quality control. A design deficiency exists when the reviewed firm's quality control policies and procedures, even if fully complied with, are not likely to meet the requirements of the quality control standards.
- .108 The significance of design deficiencies noted in the quality control policies and procedures, individually and in the aggregate, should be evaluated in the context of the reviewed firm's organizational structure and the nature of its practice. An apparent deficiency in certain quality control policies and procedures may be partially or wholly offset by other policies or procedures. Therefore, the review team should consider the interrelationships among the elements of quality control and weigh apparent deficiencies against compensating policies and procedures.
- .109 Deficiencies in the design of a system of quality control would be significant, and a modified report should be issued, if the design of the system resulted in a condition being created in which a firm did not have reasonable assurance of conforming with professional standards. For example, a failure to establish appropriate procedures for reviewing accountants' reports and accompanying financial statements may result in engagements that do not meet the requirements of professional standards.

- .110 In forming a conclusion about the design of the system of quality control, a review team should consider the implications of the evidence obtained during its evaluation of the system of quality control and its tests of compliance, including its review of engagements. Thus, the review team should consider whether failures to comply or document compliance with professional standards—particularly failures requiring application of SAS No. 1 (AICPA, Professional Standards, vol. 1, AU sec. 561) and SAS No. 46 (AICPA, Professional Standards, vol. 1, AU sec. 390) are indicative of significant design deficiencies in the reviewed firm's quality control policies and procedures. A review team may conclude that a significant design deficiency exists even though it did not result in any deficiencies in the engagements reviewed.

#### ***Noncompliance With Quality Control Policies and Procedures***

- .111 The degree of compliance by the personnel of the reviewed firm with its prescribed quality control policies and procedures should be adequate to provide the reviewed firm with reasonable assurance of conforming with professional standards. Because a variance in individual performance and professional interpretation will affect the degree of compliance, adherence to all policies and procedures in every case may not be possible.
- .112 In assessing whether the degree of compliance was adequate to provide the required assurance, the review team should consider the nature, causes, pattern, and pervasiveness of the instances of noncompliance noted, and their implications for the firm's system of quality control as a whole, not merely their importance in the specific circumstances in which they were observed. (Noncompliance with a given quality control procedure does not necessarily mean noncompliance with professional standards). To determine the degree of noncompliance, the review team should evaluate the instances of noncompliance, both individually and collectively, recognizing that adherence to certain policies or procedures of the reviewed firm is more critical to that firm's obtaining reasonable assurance of meeting professional standards than adherence to others. In this connection the review team should consider the likelihood that noncompliance with a given quality control policy or procedure could have resulted in engagements not being performed in conformity with professional standards. The more direct the relationship between a specific quality control policy or procedure and the application of professional standards, the higher the degree of compliance should have been to warrant the issuance of a

## 2042 Standards for Performing and Reporting on Peer Reviews

modified report.

- .113 If a review team concludes that the nature, causes, pattern, pervasiveness, or implications of instances of noncompliance are of such significance, individually or in the aggregate, that the reviewed firm's degree of compliance with its prescribed quality control policies and procedures did not provide it with reasonable assurance of conforming with professional standards, a modified report should be issued. In addition, when the nature and degree of noncompliance at one or more offices of a multi-office firm were of such significance that the office did not have reasonable assurance of conforming with professional standards, the review team should consider whether a modified report should be issued, even though the degree of compliance for the remainder of the firm provided the firm as a whole with reasonable assurance of conforming with professional standards.<sup>26</sup>

### ***Noncompliance With Membership Requirements***

- .114 The review team should evaluate whether the reviewed 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 be possible, a high degree of compliance is expected. In evaluating the significance of instances of noncompliance with a membership requirement, the review team should recognize that those requirements directly related to the quality of performance on accounting and auditing engagements usually are more critical.

### **Letter of Comments**

- .115 The review team ordinarily will issue a letter of comments (letter) concurrently with its report. The major objectives of the letter are to report matters, including the matters, if any, that resulted in a modified report, that the review team believes resulted in conditions being created in which there was more than a remote possibility that the firm would not conform with professional standards and, if appropriate, to

---

<sup>26</sup> If the review team concludes that these matters are not of such significance to warrant a modified report, the review team should consider whether the matters should be included in the letter of comments. (See discussion under "Letter of Comments", SECPS §2000.114-.119.)

set forth recommendations regarding those matters.<sup>27</sup>

### **Contents of the Letter**

- .116 The letter should be addressed, dated, and signed in the same manner as the report. It should include-
- a. A reference to the report indicating if it was modified or adverse.
  - b. A description of the purpose of the peer review.
  - c. A statement that the review was performed in accordance with standards promulgated by the Section.
  - d. A description of the limitations of a system of quality control.
  - e. The reviewer's findings.
  - f. A statement that the matters discussed in the letter were considered in determining the opinion on the system of quality control.
- .117 If any of the matters to be included in the letter were included in the letter issued concerning the firm's last peer review, that fact ordinarily should be noted in the description of the matter. In addition, the review team should indicate how corrective actions might be implemented. The letter may also include comments concerning the actions taken, in process, or to be taken by the reviewed firm.
- .118 SECPS §2200, *Guidelines for and Illustrations of the Letter of Comments*, illustrate how the foregoing matters may be covered in a letter of comments.

### **Matters to Be Included in the Letter of Comments**

- .119 If a modified peer review report is issued, the accompanying letter of comments must include a section on the matters that resulted in the modification. This section would ordinarily

---

<sup>27</sup> Remote has the same meaning in these standards as in Financial Accounting Standards Board (FASB), *Statement of Financial Accounting Standards No. 5, Accounting for Contingencies*, paragraph 3c, in which remote is defined as slight.

## 2044 Standards for Performing and Reporting on Peer Reviews

include an elaboration of the findings discussed in the modifying paragraph of the report.

- .120 In addition to any matters that resulted in a modified report, the letter should include other appropriate comments, as discussed below, regarding the design of the reviewed firm's system of quality control, or its compliance with that system (including professional standards) or with the membership requirements of the Section.

a. Comments regarding the design of the firm's system of quality control-Deficiencies in the design of the reviewed firm's system of quality control should be included in the letter if the design of the system resulted in a condition being created in which there was more than a remote possibility that the firm would not conform with professional standards, even though the firm had reasonable assurance of conforming with professional standards. The letter should include comments on such deficiencies even if they did not result in deficiencies on the engagements reviewed. When engagement deficiencies, particularly instances of nonconformity with professional standards, were attributable to such design deficiencies, the presence of the engagement deficiencies ordinarily should be noted in the comment along with the description of the design deficiency.<sup>28</sup>

b. Noncompliance with the firm's system of quality control-Instances of noncompliance with significant firm policies or procedures should be included in the letter whenever the degree of such noncompliance created a condition in which there was more than a remote possibility that the firm would not conform with professional standards, even though the degree of noncompliance was not such as to warrant a modified report. (See also the discussion on noncompliance in SECPS §2000.110-.113.)

1. In assessing whether the degree of noncompliance created such a condition, the review team should consider the

---

<sup>28</sup> Nonconformity with professional standards refers to situations in which the review team concluded that the reviewed firm should consider taking action pursuant to SAS No. 1, (AICPA Professional Standards, vol. 1, AU sec. 561) and SAS No. 46, (AICPA Professional Standards, vol. 1, AU sec. 390) or in which the review team concluded that the firm lacked a reasonable basis under the standards for accounting and review services or the attestation standards for its report.

nature, causes, pattern, and pervasiveness of the instances of noncompliance noted, as well as the implications for the firm's system of quality control as a whole, not merely the importance in the specific circumstances in which the instances were observed. To do this, the review team should evaluate the instances of noncompliance, both individually and collectively, recognizing that adherence to certain policies or procedures is more critical to assuring conformity with professional standards than is adherence to others. Accordingly, a higher degree of compliance should be expected for the more critical policies and procedures. However, noncompliance with quality control policies and procedures that are less critical to assuring conformity with professional standards may also be reportable in a letter of comments. For example, failures to comply with the firm's personnel management policies could create a condition in which there was more than a remote possibility that the firm would not conform with professional standards, either currently or in the future. When engagement deficiencies - particularly instances of nonconformity with professional standards - were attributable to the instances of noncompliance with significant firm policies or procedures that are included in the letter, the review team ordinarily should include that information in the comment along with the description of the instances of noncompliance with the significant firm policy or procedure.

2. When the nature and degree of noncompliance at one or more offices of a multi-office firm were of such significance that a condition was created in which there was more than a remote possibility that the office would not conform with professional standards, the review team should consider whether the matter should be included in the letter of comments, even though the degree of compliance for the remainder of the firm did not create such a condition with respect to the firm as a whole.
3. While isolated instances of noncompliance ordinarily would not be included in a letter, their nature, importance, causes (if determinable), and implications for the firm's system of quality control as a whole should be evaluated in conjunction with the review team's other findings before making a final determination.



## 2046 Standards for Performing and Reporting on Peer Reviews

- c. Noncompliance with membership requirements—The review team should evaluate whether the firm complied in all material respects with each of the membership requirements of the Section. When the firm had not achieved a very high degree of compliance with a membership requirement of the Section, that fact should ordinarily be included in the letter. In evaluating the significance of instances of noncompliance with a membership requirement, the review team should recognize that those requirements directly related to the quality of performance on engagements usually are more critical.

### Letter of Response

- .121 The reviewed firm is required to respond in writing to the review team's comments on matters in the letter of comments. The response should be addressed to the SECPS Peer Review Committee and should describe the actions taken or planned with respect to each matter in the letter. If the reviewed firm disagrees with one or more of the comments, its response should submit the reasons for such disagreement. The reviewed firm should submit the response to the team captain for review and comment before submitting the response to the Committee. (SECPS §2300, *Suggestions for Writing a Response to a Letter of Comments*, illustrates how a firm may respond to a letter of comments.)

### Engagement Terminated Before Completion

- .122 A member firm or a reviewer may not terminate a peer review before its completion without the prior approval of the Committee chair or his or her designee. Such approval will be withheld when the review team has noted significant deficiencies related to engagements.
- .123 If a review is terminated before completion, the review team should advise the reviewed firm and the Section in writing of the reasons for the termination.

### Disagreement Within Review Teams

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

COMMITTEE CONSIDERATION OF REPORTS ON PEER REVIEWS

- .125 The report on a peer review is to be sent to the SECPS Peer Review Committee with the letter of comments, if any, and the response to that letter by the reviewed firm. In addition, a copy of the summary review memorandum is to be sent to the Committee for reviews of firms with 30 or more SEC audit clients and also when the Committee or its staff believes it is appropriate to do so. Upon acceptance by the Committee, the peer review report, letter of comments, and the reviewed firm's letter of response are placed in the public files.
- .126 Before acceptance, the staff of the Committee reviews all or selected working papers of the review team, evaluates whether the findings are properly reported upon, and reports its conclusions to the Committee. The Committee reviews each report, letter of comments, if any, the reviewed firm's response to it, and the comments of the Committee's staff and, if applicable, of the Public Oversight Board or its staff. The Committee considers whether
- a. The review has been performed in accordance with the Section's standards for performing peer reviews.
  - b. The report, letter of comments, and the response thereto are in accordance with the Section's standards for reporting on peer reviews.
  - c. It should take any action concerning matters contained in the letter of comments, including any matters that resulted in a modified report.
- .127 In reaching its conclusions, the Committee will make whatever inquiries or initiate whatever actions it considers necessary in the circumstances. These actions might include, but are not limited to, one or more of the following:
- a. Obtaining additional information from, or meeting with, the review team or the reviewed firm to achieve a better understanding of the facts and circumstances.

## 2048 Standards for Performing and Reporting on Peer Reviews

- b. Requesting the review team to revise the report or the letter of comments.<sup>29</sup>
  - c. Obtaining additional written assurance from the reviewed firm regarding when and how a matter giving rise to a modification, if any, or included in the letter of comments will be treated.
- .128 If further inquiry or action is initiated, a Committee member may be assigned to follow the matter until it is concluded.
- .129 Ordinarily, a report is accompanied by a letter of comments. In evaluating the report, letter of comments, and the reviewed firm's response thereto, and after concluding any inquiry or action described above, the Committee will consider what additional actions, if any, are necessary by the reviewed firm or the Committee in connection with the acceptance of these documents. When additional actions are required, they may include, but are not limited to, the following:
- a. Obtaining documentary evidence that the matter has been appropriately treated by the reviewed firm.
  - b. Requesting the reviewed firm, at the firm's expense, to have a revisit by the team captain or other party during the performance of its monitoring procedures.
  - c. Requesting the reviewed firm, at the firm's expense, to engage a reviewer to revisit the firm to evaluate whether appropriate action has been taken.
  - d. Requesting the reviewed firm, at the firm's expense, to engage the team captain or other party to review the documentation supporting the action(s) taken on an engagement reviewed during the peer review for which the reviewed firm concluded that it had failed to reach an appropriate conclusion on the application of professional standards.

---

<sup>29</sup> For firms with SEC clients, the revised peer review documents must be received within 15 business days from Committee acceptance. For firms with no SEC clients, the revised peer review documents must be received within 30 calendar days from Committee acceptance. If the revised peer review documents are not received within the allotted time, the peer review will be considered deferred and will be reconsidered at the Committee's next meeting.

- e. Requesting firm personnel to obtain additional appropriate CPE.
  - f. Requesting the reviewed firm, at the firm's expense, to hire a competent party from outside the firm to perform a preissuance review of reports, accompanying financial statements, and related working papers, and to perform such other functions as the Committee or the firm deems appropriate.
  - g. Requesting the reviewed firm to accelerate the date of its next peer review.
  - h. Recommending to the SECPS Executive Committee that sanctions be imposed on the reviewed firm.
- .130 Several factors influence the Committee's decisions. The factors include the Committee's judgment regarding:
- a. The nature and significance of the matters in the letter of comments.
  - b. Whether the reviewed firm's response presents either a satisfactory course of action or convinces the Committee that additional action is unnecessary.
  - c. Whether the reviewed firm's response to a matter appears to be an arbitrary rejection of the comment or an inappropriate conclusion not to take suitable action.
- .131 If no additional actions are deemed necessary, the report, the letter of comments, and the reviewed firm's response thereto will be placed in the public files. If additional actions are deemed necessary by the Committee, these documents will be placed in the public file along with a memorandum indicating that they have been accepted with the understanding that the firm will agree to take certain actions. The letter setting forth those actions and the firm's agreement to undertake them will be placed in the public files upon receipt. (See Appendix G, SECPS §1000.40, regarding the reviewed firm's obligation to cooperate until the matter is resolved and until the firm has taken the corrective actions, if any, deemed necessary by the Committee.)
- .132 In unusual circumstances, the Committee may deem it appropriate to place in the public files reports, letters of comments, and responses to the letters by reviewed firms before they have been accepted. In such circumstances, the public file is supplemented with a memorandum stating that

## 2050 Standards for Performing and Reporting on Peer Reviews

further inquiry has been initiated or describing the actions.

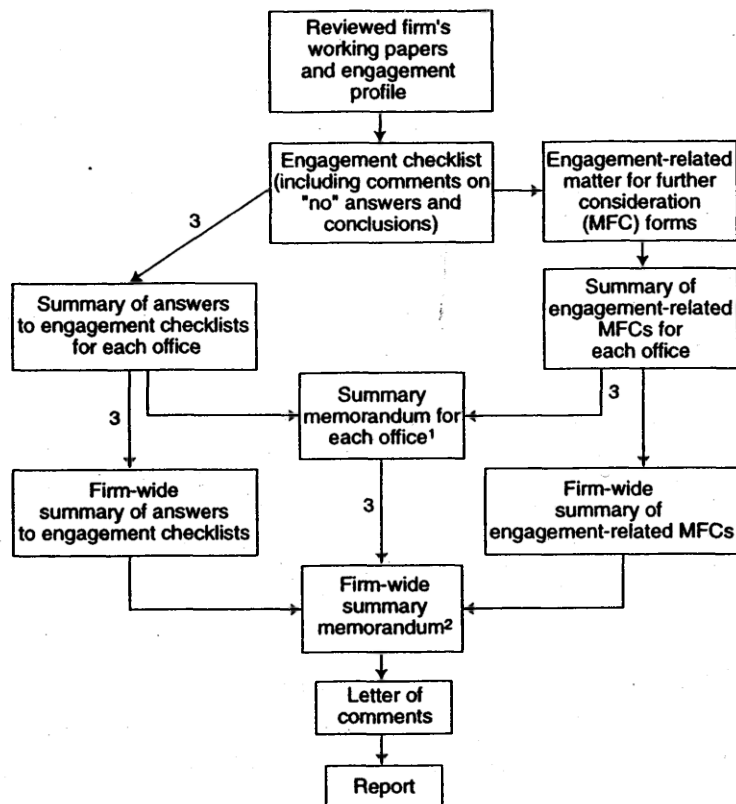
### Disagreement Between Committee and Review Team

- .133 If, after completing consideration of the report on a peer review and after making such inquiries as deemed appropriate, a majority of the Committee members eligible to vote on matters related to that peer review disagree with the report issued by the review team, the review team will be requested to revise its report. If the review team will not revise its report, the Committee may refuse to accept the report. Alternatively, the Committee may decide to appoint two qualified individuals, at least one of whom will be a Committee member, to serve as an evaluation panel. The Committee will designate one panel member to serve as the chair.
- .134 The purpose of the evaluation panel is to perform sufficient procedures to provide a basis for the panel to issue its own report and, if necessary, letter of comments. Concurrent with the issuance of its report, the evaluation panel will forward its working papers to the Committee.
- .135 The panel's report and, if applicable, the letter of comments and the reviewed firm's response thereto will be considered by the Committee and, after acceptance, placed in the public files. The report and letter of comments issued by the original review team will be retained in the nonpublic files.

### EFFECTIVE DATE

- .136 The provisions of these Standards are applicable to peer reviews on firm's system of quality control for its accounting and auditing practice conducted on or after July 1, 1997.

## .137 Exhibit A—Flow of Peer Review Working Papers Relating to Engagements (Multi-office Firms)

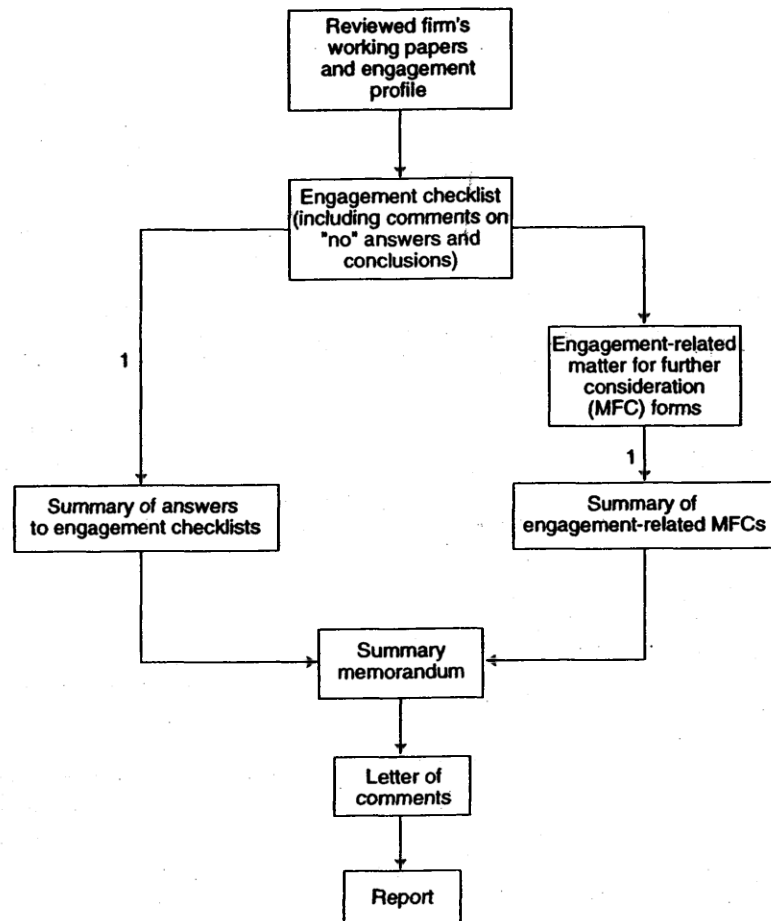


1. These memorandums summarize findings relating to functional area compliance testing at each practice office and engagement review findings.
2. This memorandum summarizes on a firm-wide basis engagement and functional area review findings at practice offices reviewed and at the firm's executive office.
3. A combining working paper shows the trail from the individual documents to the summary.

Note: See the loose-leaf SEC Practice Section Peer Review Program Manual for a sample engagement profile, sample engagement checklists, a sample "Matter for Further Consideration" form, and a sample summary memorandum questionnaire.

2052 Standards for Performing and Reporting on Peer Reviews

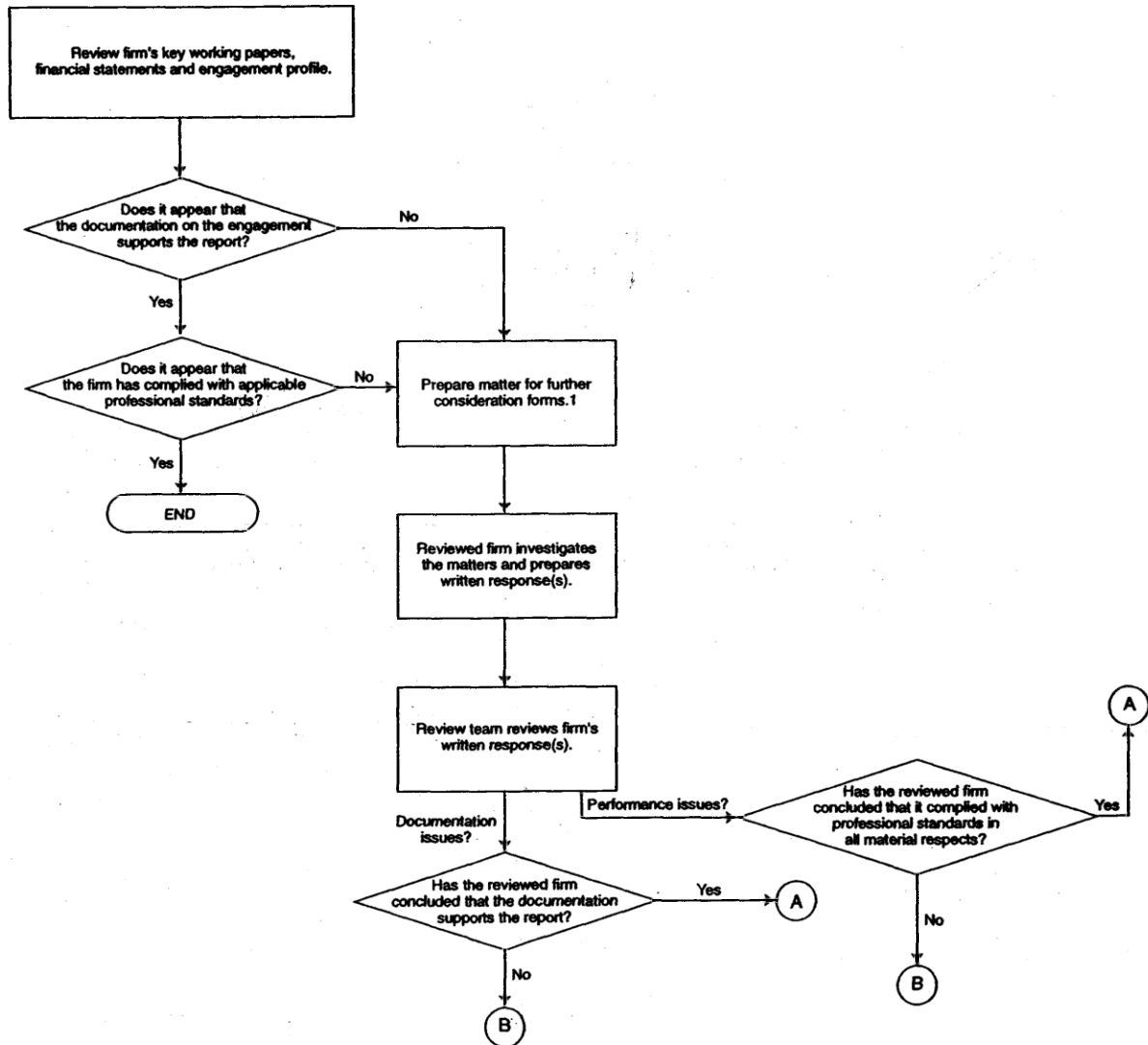
.138 Exhibit B—Flow of Peer Review Working Papers Relating to Engagements (Single-office Firms)



1. A combining working paper shows the trail from the individual documents to the summary.

*Note:* See the loose-leaf SEC Practice Section Peer Review Program Manual for a sample engagement profile, sample engagement checklist, a sample "Matter for Further Consideration" form, and a sample summary memorandum questionnaire.

.139 Exhibit C—Review of Engagements



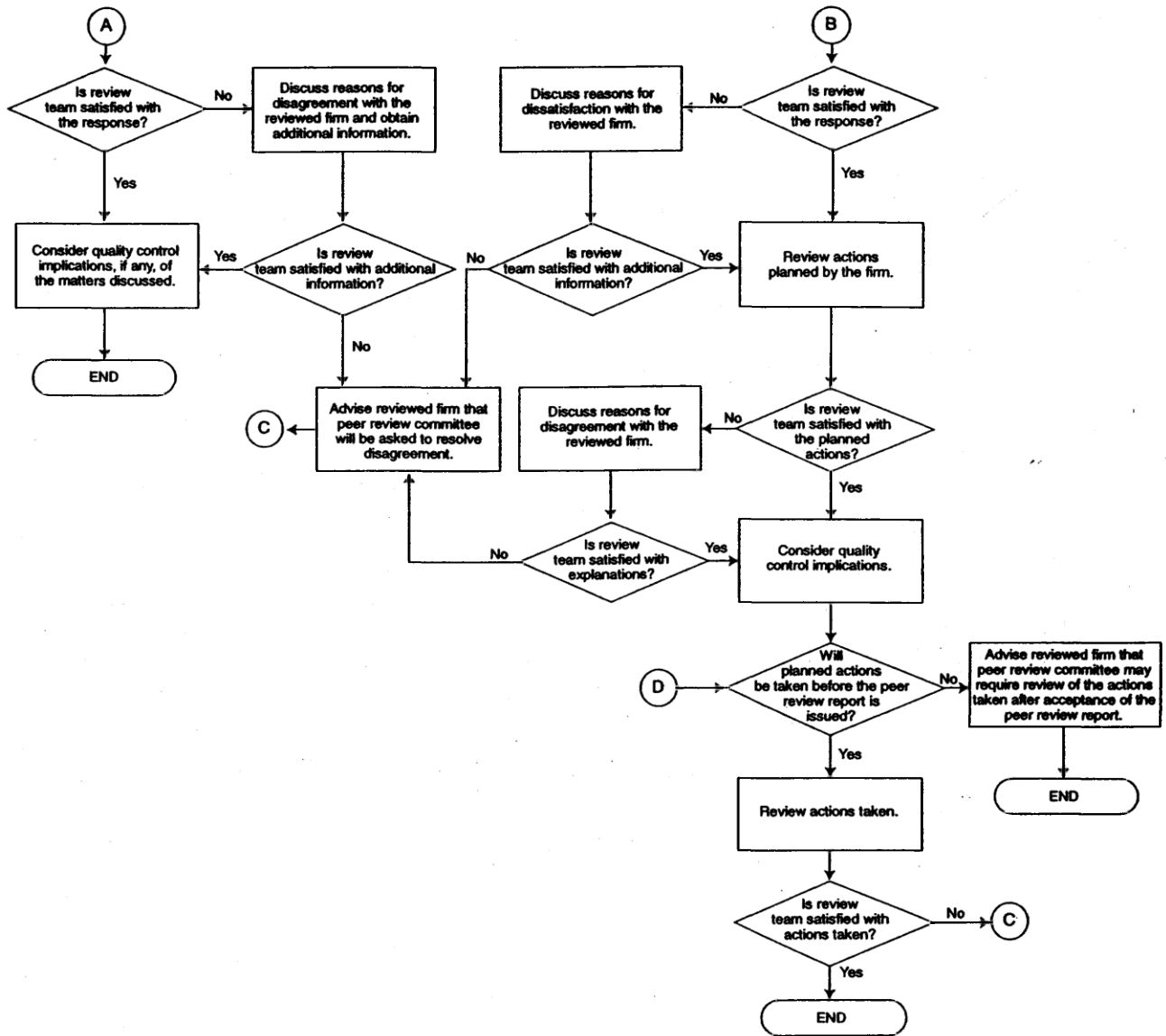
(continued)

1. "Matter for Further Consideration" forms can also be prepared when it appears the reviewed firm may not have complied with quality control policies or procedures.



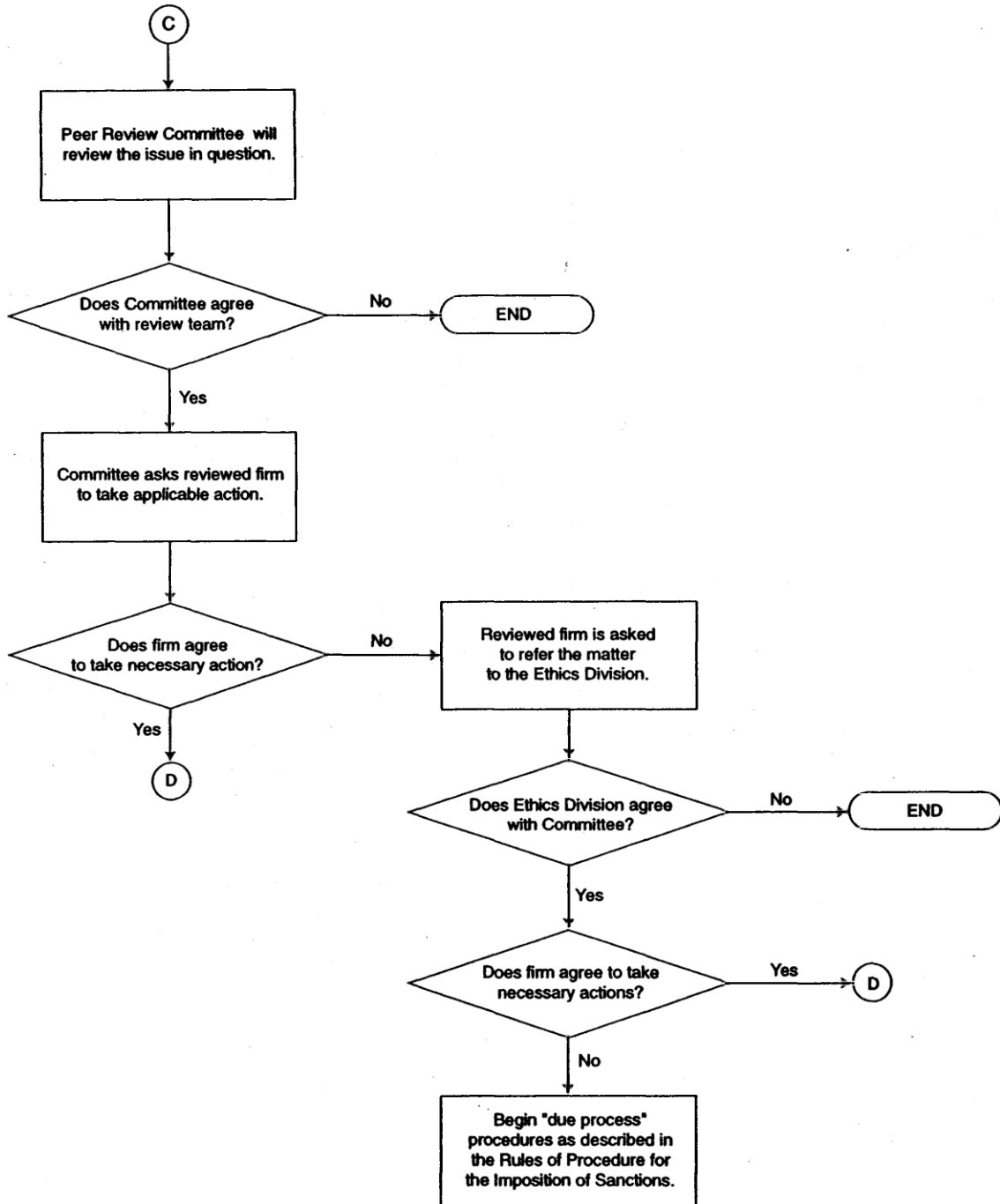
2054 Standards for Performing and Reporting on Peer Reviews

.139 Exhibit C-Review of Engagements (continued)



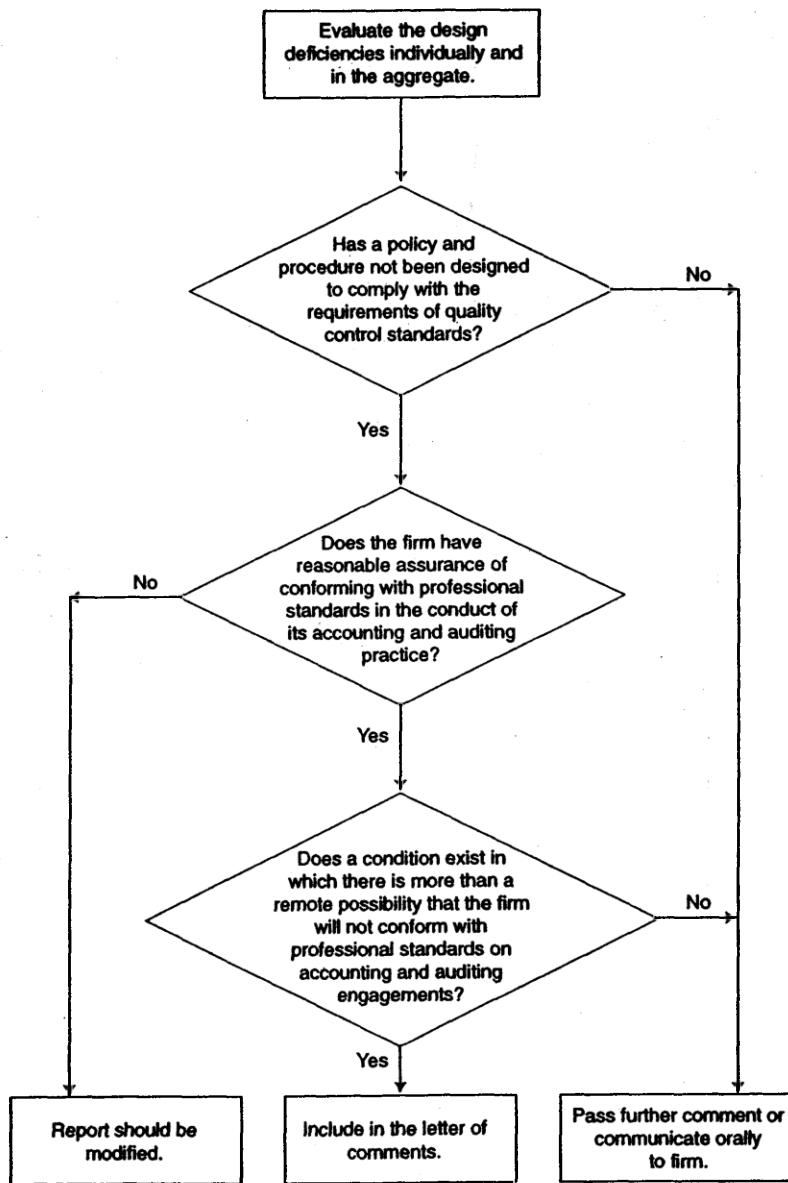
(continued)

.139 Exhibit C—Review of Engagements (continued)

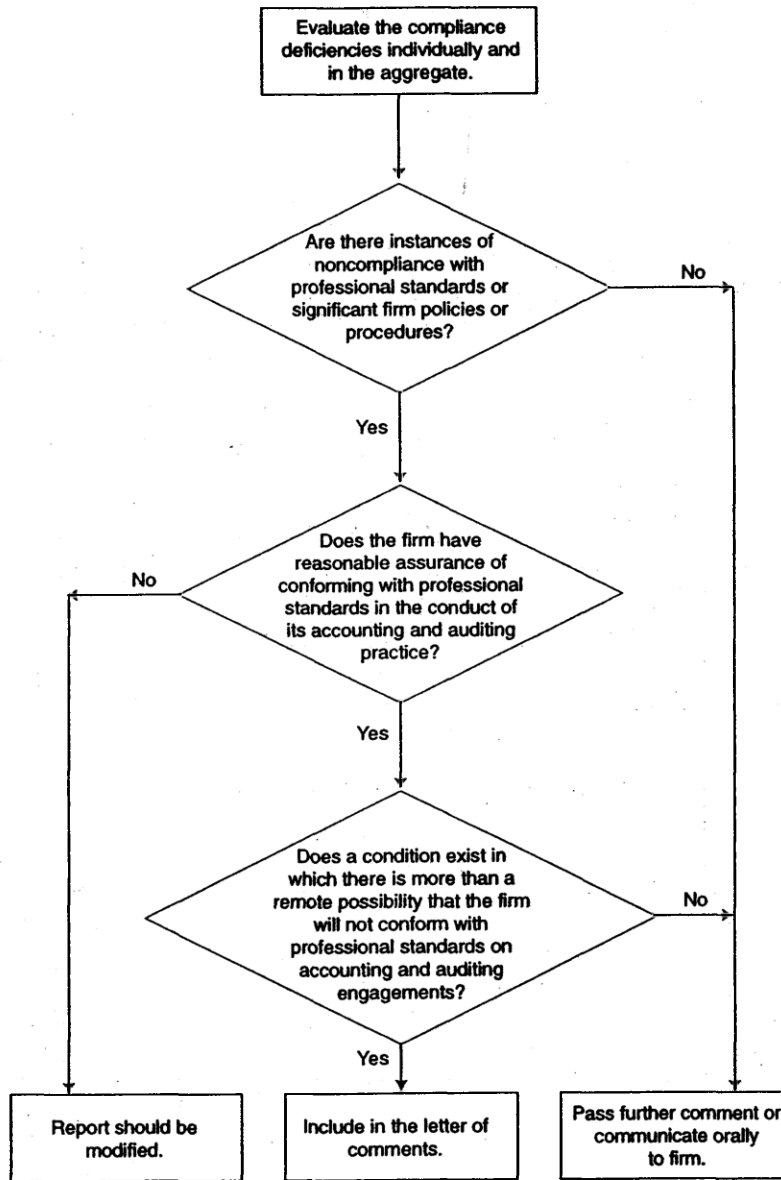


2056 Standards for Performing and Reporting on Peer Reviews

.140 Exhibit D-Design Deficiencies

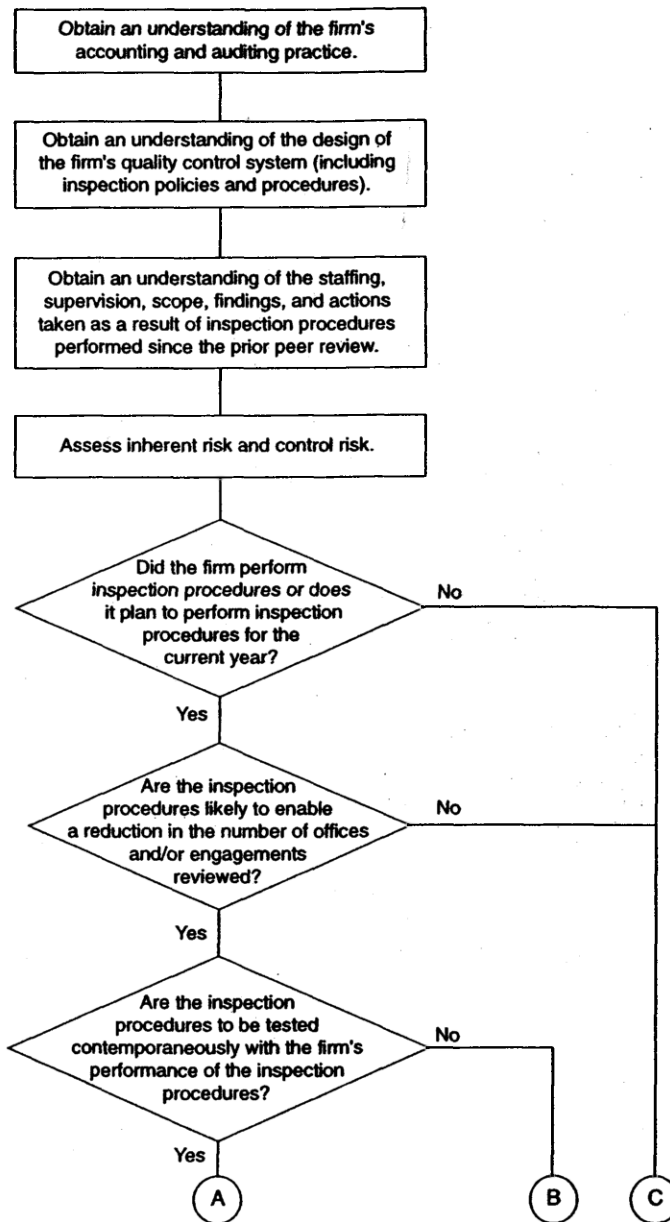


.141 Exhibit E—Compliance Deficiencies (Other Than With a Membership Requirement)

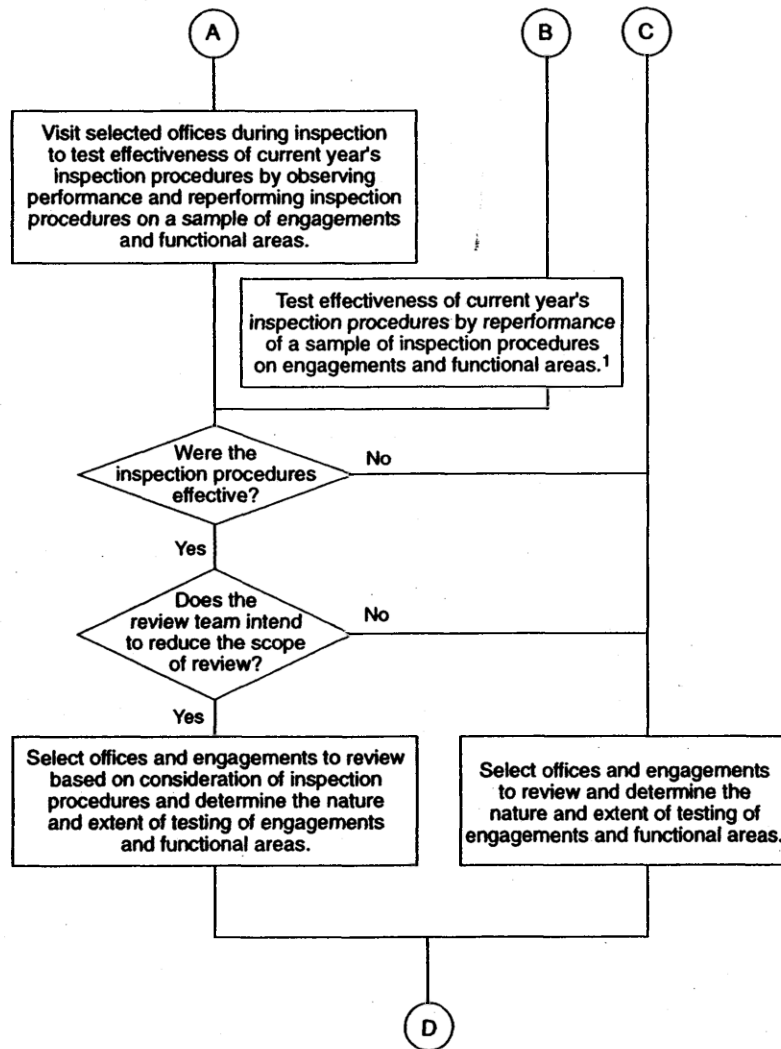


2058 Standards for Performing and Reporting on Peer Reviews

.142 Exhibit F—Flow of Peer Review office and Engagement Selection



.142 Exhibit F—Flow of Peer Review Office and Engagement Selection  
(continued)

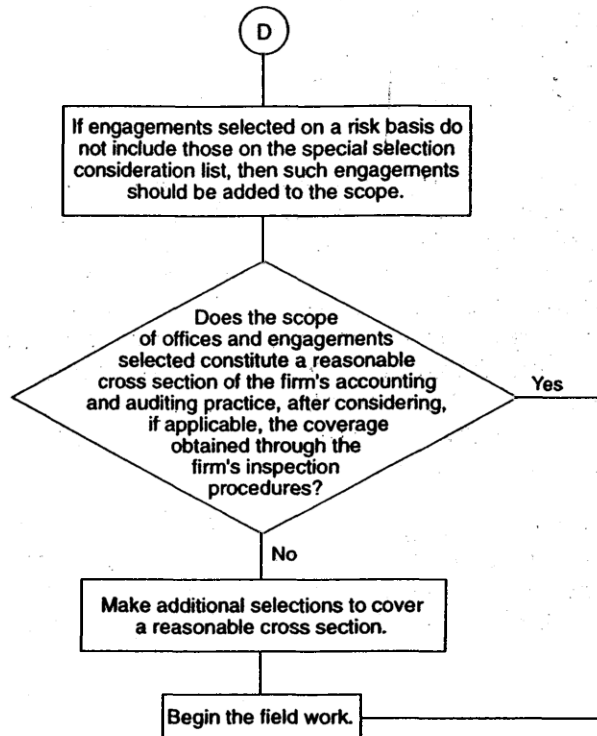


(continued)

1. The sample in B will be larger than the one in A since the actual inspection procedures are not being observed.

2060 Standards for Performing and Reporting on Peer Reviews

.142 Exhibit F—Flow of Peer Review Office and Engagement Selection  
(continued)



**.143 APPENDIX A—Interpretation: Independence, Integrity, and Objectivity**

1. Services provided by one accounting firm for another do not impair independence, integrity, and objectivity provided (a) the fees for such services are not material to either the reviewed firm or the reviewing firm, and (b) the services are not an integral part of the reviewed firm's system of quality control other than the monitoring function. With respect to (b), providing services that are an integral part of the reviewed firm's system of quality control would not impair independence provided the services are reviewed by an independent party.
2. For the purposes of the program, independence is impaired when two or more firms or a group of firms (whether a formal or informal group) are involved in jointly marketing or selling services on behalf of one or more identifiable firms, unless the representations in the marketing or selling materials concerning the quality of the firms or their services are objective or quantifiable. When independence is impaired, the firms involved in the joint marketing or selling activities are precluded from participating in the peer review of another of the identifiable firms.
3. The independence, integrity, and objectivity requirements also apply to Committee members and others involved in reviewing working papers prepared in conjunction with a peer review; however, the requirements do not apply to such individuals' firms.

**Examples**

4. The following examples illustrate how the independence, integrity, and objectivity requirements are to be interpreted.

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

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

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



## 2062 Standards for Performing and Reporting on Peer Reviews

Answer. Yes.

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

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

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

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

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

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

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

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

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

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

Question 8. Firm A performs a peer review of Firm B. Subsequently, Firm C performs a peer review of Firm B, and Firm D of Firm A. Would the restriction against reciprocity be violated if Firm B were now to review Firm A?

Answer. No. Although the *Standards for Performing and Reporting on Peer Reviews* state that reciprocal reviews are not permitted, that provision is intended only to prohibit back-to-back reviews when each firm has not had an intervening review by another firm or team.

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

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

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

Answer. Yes.

Question 11. Firm A included the qualifications of Firm B in a proposal for one or more specific engagements. Could either firm perform a peer review of the other following a successful proposal?

Answer. No, unless any fees paid to Firm B are not material to either of the firms; the firms do not share directly or indirectly, or participate in, the profits of the other; the firms do not share fees, office facilities or professional staff; the firms do not have joint ownership of a for-profit

## 2064 Standards for Performing and Reporting on Peer Reviews

entity; and the firms do not exercise any direct or indirect management control over the professional or administrative functions of the other.

Question 12. A group of firms (whether or not it uses a common name) places an advertisement in a trade journal indicating that its members are "specialists" and provide the "best advice". Although the firms are not specifically identified in the advertisement, a toll-free telephone number or Internet site is provided for contact. Can one firm in the group perform the peer review of another member firm in the same group?

Answer. No, because the group is marketing or selling services to potential clients on behalf of the firms where the representations about the firms and the quality of their services are not objective or quantifiable.

Question 13. A group of firms (whether or not it uses a common name) places an advertisement in a trade journal. The advertisement indicates the number and geographical location of the member firms, and states that its members provide professional accounting and auditing services to over 2500 industry clients nationwide and that each of the member firms passed its most recent peer review. A toll-free telephone number or Internet site is provided for contact. Can one firm in the group perform the peer review of another member firm in the same group?

Answer. Yes, provided the group has filed a plan of administration with the AICPA Practice Monitoring Department that has been accepted by the SECPS Peer Review Committee since the representations in the advertisement are objective or quantifiable.

Question 14. A state CPA society places an advertisement promoting the CPA profession without identifying any specific firms. May firms whose personnel belong to that state society provide peer review for each other?

Answer. Yes.

**.144 APPENDIX B-Interpretation: Selecting the Review Year**

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

## 2066 Standards for Performing and Reporting on Peer Reviews

### .145 APPENDIX C—Work Performed by Other Auditors

#### General

1. The review should be concerned with the accounting and auditing engagements performed by the U.S. offices of the reviewed firm selected for review and with the supervision and control, in accordance with U.S. professional standards, of work on segments of such engagements performed by foreign offices or by domestic or foreign affiliates or correspondents (hereinafter "other auditors"). In this context, supervision and control of work performed by other auditors does not include matters related to the development, by the principal auditor, of an overall strategy for the expected conduct and scope of the examination of the financial statements of the entity as a whole. For example, the decision about the number of foreign locations to be selected for the application of auditing procedures, although considered in the peer review process, is not a part of the supervision and control of that foreign work.
2. For purposes of peer review, the principal auditor's working papers or other documentation maintained within the firm should include documentation of the following matters when the principal auditor does not make reference to the examination of the other auditor. The documentation required by items 3 through 5 could be satisfied on an individual engagement basis, on a firm-wide basis, or by a combination thereof; the documentation required by items 6 through 9 should be on an individual engagement basis.

#### Engagement or Firm-Wide Documentation Basis

3. The following should serve as the basis for engagement or firm wide documentation:
  - a. The professional reputation of the other auditor.
  - b. The independence of the other auditor in conformity with the requirements of the American Institute of Certified Public Accountants and, if appropriate, the requirements of the Securities and Exchange Commission (SEC).
4. The procedures followed to obtain reasonable assurance that personnel of the other auditor responsible for performing the work on components of the entity are familiar with are-
  - a. U.S. generally accepted accounting principles and U.S. generally accepted auditing standards.

- b. Relevant financial reporting requirements for statements and schedules to be filed with regulatory agencies such as the SEC, if appropriate.
- c. Applicable policies of the principal auditor.

**Engagement Documentation Basis**

- 5. The engagement documentation basis consists of-
  - a. Communications from the principal auditor to the other auditor sufficiently in advance of the date the work is to be commenced and subsequently thereafter, as necessary, concerning-
    - 1. The scope of the other auditor's work deemed necessary in connection with the review of the consolidation of the entity's financial statements.
    - 2. Potential problem areas and special considerations that may require extension or modification of audit tests.
    - 3. Related parties Statement on Auditing Standards (SAS) No. 45, Omnibus Statement on Auditing Standards-1983, (AICPA, Professional Standards, vol. 1, AU sec. 334).
    - 4. Other matters coming to the attention of the principal auditor that might have a bearing on the work performed by the other auditor.
  - b. Communications from the other auditor to the principal auditor concerning-
    - 1. Circumstances that caused the other auditor to depart from the scope of work outlined by the principal auditor or to make significant changes in the audit plan if that plan had been provided to the principal auditor, and problem areas and special considerations that had not been previously communicated to the other auditor by the principal auditor.
    - 2. Adjustments made and possible adjustments not made.
    - 3. A representation that the work was performed in accordance with the principal auditor's instructions and a discussion of unusual accounting and auditing matters and conclusions reached.

## 2068 Standards for Performing and Reporting on Peer Reviews

4. Information needed by the principal auditor in connection with the review of the consolidation of the entity's financial statements—for example, information necessary to ascertain the uniformity of accounting practices among components included in the consolidated financial statements and information on intercompany transactions and accounts, related-party transactions, maturities of long-term debt, and similar matters.
- c. Follow-up by the principal auditor on any matters that may have been referred by the other auditor for consideration or resolution.
- d. Consideration given by the principal auditor to visiting the other auditor. When visits are made, the procedures performed and conclusions reached should be documented.

### Selection of Engagements for Review

6. The selection of engagements for review, in some instances, may not have provided the review team with an adequate sample of a firm's practice involving work performed by foreign offices or domestic or foreign affiliates or correspondents to enable the review team to test the application of the firm's policies and procedures for supervision and control of such work. In that circumstance, the review team should consider a supplementary selection of engagements for limited review, directed to the supervision and control of work performed by foreign offices or by domestic or foreign affiliates or correspondents.

### Effect of an International Organization

7. When individual engagement management relies on the policies and procedures followed with the firm's international organization with respect to one or more of the matters previously discussed under Engagement or Firm-Wide Documentation Basis, the firm should provide the review team with documentation that supports such reliance. A review team should evaluate the adequacy of those policies and procedures and test compliance with them. It is recognized that such policies and procedures may include monitoring (e.g., inspection) policies and procedures that may provide the U.S. firm with satisfaction about those matters.
8. Satisfactory conclusions concerning the adequacy of and compliance with the policies and procedures followed within the firm's international organization would reduce the review team's scope of review of evidence of supervision and control

of work performed outside the United States. For example, it may be appropriate for the review team to review the supervision and control of work performed outside the United States on only some of the auditing engagements performed by the U.S. offices of the reviewed firm.

**[The next page is 2071]**



## .146 APPENDIX D—Selecting Engagements for Review

1. The review team's coverage of engagements should be consistent with its assessment of the combined levels of inherent and control risk associated with the reviewed firm's accounting and auditing practice and its system of quality control, and the consideration, if any, given by the review team to the effectiveness of the reviewed firm's inspection procedures for the review year. The team also should satisfy the special engagement selection considerations in the peer review standards (SECPS §2000.76). By applying the guidance in the responses to the ensuing questions, reviewers can achieve these objectives without devoting unnecessary time to the review.

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

In the peer review of a small or medium-sized firm, selection of a large or complex audit for review might seem to result in too much time being spent performing the review. Applying the "key audit area" concept carefully to large or complex engagements may keep the review hours within reasonable limits. (See "Extent of Engagement Review" SECPS §2000.83-.89, and "General Instructions to Reviewers" in the SEC Practice Section Peer Review Program Manual for discussions regarding emphasis on key audit areas.)

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

Ordinarily, in applying the "key audit area" concept, all the key audit areas should be reviewed. Reviewers may decide, however, not to review all key areas. For example, in some of the initial audit engagements selected for review, attention might be limited to the client and engagement acceptance procedures; the steps taken to gain knowledge and understanding of the client's business; the evaluation of the client's control environment, accounting system and control activities as a basis for developing the audit program; and an evaluation of the planned audit procedures. Similarly, in some specialized industry engagements selected for review, attention might be limited to an evaluation of the experience, expertise, and training of the personnel assigned to the work; an evaluation of the planned audit procedures in areas unique to that industry; and a determination whether the financial statements are in the appropriate form for an entity operating in that

## 2072 Standards for Performing and Reporting on Peer Reviews

industry. Likewise, a review of selected compilation engagements might be limited to reading the reports and financial statements to consider whether they appear to be in conformity with professional standards. In such cases, only the portion of the total hours related to the key areas or aspects of the engagement actually reviewed should be included in the computation of the accounting and auditing hours reviewed.

- c. Does the work of most supervisory personnel have to be reviewed?

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

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

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

2. Selecting engagements for review and applying the considerations mentioned above require the application of professional judgment. However, reviewers should not avoid selecting engagements that would satisfy pertinent selection criteria but that, because of their size, would require considerable review hours. In such cases, it would be preferable to restrict the review procedures applied to the specific engagements rather than to apply no procedures at all to such engagements.

**.147 APPENDIX E—Interpretation: Communicating Engagements Selected to the Reviewed Firm**

1. Question. Should the reviewed firm (or office) be notified in advance of the engagements to be reviewed?
2. Interpretation. An initial selection of engagements should be made in advance to enable the reviewed firm (or office) to prepare needed client profile information and to assemble the necessary files before the review team's arrival. The number of engagements so selected should be sufficient to enable the review team members to work efficiently immediately upon their arrival. To minimize any inference that advance selections may afford undue opportunities for last-minute "clean-up" of the files, it is preferable that the selection of some engagements not be made known to the firm (or office) until the review team's arrival.

## 2074 Standards for Performing and Reporting on Peer Reviews

### .148 APPENDIX F—Interpretation: Alternative Concurring Partner Review Arrangements

1. Question: SECPS membership requirement §1000.08(f) requires a concurring review of the audit report and the financial statements by a partner other than the audit partner-in-charge of an SEC engagement before issuance of an audit report on the financial statements of an SEC engagement and before reissuance of such an audit report in circumstances in which the performance of subsequent events procedures is required by professional standards. The SECPS Peer Review Committee may authorize alternative procedures in which this requirement cannot be met because of the size of the member firm. In what circumstances would the Committee authorize a non-partner-level person to perform a concurring review?
2. Interpretation: Ordinarily, the SECPS Peer Review Committee will not authorize a non-partner-level person to perform a concurring review. The Committee believes performance of a concurring review is enhanced when it is performed by a partner-level person, especially when differences of professional opinion surface regarding accounting, auditing, or reporting matters.
3. In rare situations, the Committee has authorized a manager or equivalent supervisory person to perform a concurring review. This has usually occurred when all the following have been met:
  - a. The member firm, because of size constraints, does not have any qualified partners to perform the concurring review.
  - b. The member firm has attempted to engage a qualified partner-level person from outside the firm to perform the concurring review, but has been unable to do so.
  - c. The manager or equivalent supervisory person has the appropriate background, technical expertise, and experience to achieve the objectives of the concurring review.
4. Before using a nonpartner-level individual to perform a concurring review, a member firm must submit a letter to the SECPS Peer Review Committee requesting authorization to use such an individual. This letter should describe—
  - a. The reasons why a partner-level person cannot perform the concurring review.
  - b. The efforts made to engage a qualified partner-level person

from outside the firm to perform the concurring review.

- c. The current responsibilities and qualifications of the individual the firm wishes to perform the review.
- d. The manner in which differences of professional opinion between the concurring reviewer and the partner-in-charge of the engagement will be resolved.

## 2076 Standards for Performing and Reporting on Peer Reviews

### .149 Appendix G - Interpretation: Alternative Partner Assignment Arrangements

1. Question: SECPS membership requirement 1000.08 (e) requires "that each member firm assign an audit partner to be in charge of each SEC engagement. The SECPS Peer Review Committee ("Peer Review Committee") may authorize alternative procedures where this requirement cannot be met because of the size or structure of a member firm. Under what circumstances would the Peer Review Committee authorize a non-partner level person to be assigned the overall responsibility of an SEC engagement (i.e., to function as the partner-in-charge of the engagement)?
2. Interpretation: Ordinarily, the Peer Review Committee will not authorize a non-partner level individual to be in charge of an SEC engagement. The Peer Review Committee believes assigning the overall responsibility for an engagement to a partner-level individual enhances the overall conduct of the engagement, especially when differences of professional opinion surface regarding accounting, auditing or reporting matters.
3. In rare situations, the Peer Review Committee will authorize a manager or equivalent supervisory person to be in charge of an SEC engagement. This may occur only when all the following have been met:
  - a. The member firm, due to size constraints or the structure of the firm, does not have a qualified partner to assume the overall responsibility of an SEC engagement.
  - b. The manager or equivalent supervisory person is a CPA, and has the appropriate background, technical expertise, experience and authority to commit the firm to its opinion.
4. Prior to assigning a non-partner level individual to be in charge of an SEC engagement, a member firm must submit a letter to the Peer Review Committee requesting authorization to use such an individual. This letter should describe:
  - a. The reasons a partner-level individual cannot be assigned as the partner-in-charge of an SEC engagement.
  - b. The current responsibilities and qualifications of the individual the firm wishes to assign the overall responsibility for the SEC engagement.
  - c. The current responsibilities and qualifications of the partner-level individual assigned responsibility as the concurring reviewer.

## SECPS Section 2100

## GUIDELINES FOR AND ILLUSTRATIONS OF PEER REVIEW REPORTS

## TABLE OF CONTENTS

<u>Section</u>	<u>Paragraph</u>
2100	Guidelines for and Illustrations of Peer Review Reports
General Guidelines . . . . .	.01-.05
Guidelines for Writing Modifying Paragraphs . . . . .	.06-.25
Report Modified for Design Deficiencies.	.07-.10
Report Modified for Noncompliance With Quality Control Policies and Procedures	.11-.14
Report Modified for Noncompliance With Membership Requirements. . . . .	.15-.18
Report Modified for a Quality Control System Design Deficiency and Noncompliance With Membership Requirements . . . . .	.19-.21
Adverse Report . . . . .	.22-.25
Illustrative Reports . . . . .	.26-.32
Standard Form for an Unmodified Report	.27
Modified Report for an Engagement Performance Design Deficiency. . . . .	.28
Modified Report for Noncompliance With Quality Control Policies and Procedures	.29
Modified Report for Noncompliance With Membership Requirements. . . . .	.30
Modified Report for a Quality Control System Design Deficiency and Noncompliance With Membership Requirements. . . . .	.31
Adverse Report . . . . .	.32

## Guidelines for and Illustrations of Peer Review Reports

### GENERAL GUIDELINES

- .01 A review team may issue one of the following types of reports:
- a. An unmodified report
  - b. A report modified due to one of the following:
    1. an engagement performance design deficiency
    2. noncompliance with quality control policies and procedures
    3. noncompliance with membership requirements  
a quality control system design deficiency and noncompliance with membership requirements
    4. an adverse opinion
- .02 The report should contain—
- a. An indication of what a system of quality control encompasses and a reference to the Quality Control Standards.
  - b. A statement indicating that the system of quality control is the responsibility of the reviewed firm.
  - c. An indication that the review was performed in accordance with standards promulgated by the Peer Review Committee of the SEC Practice Section.
  - d. An indication of the scope of the review, including any limitations thereon.
  - e. A reference to the letter of comments, if such a letter was issued.
  - f. An opinion on whether the reviewed firm's quality control system has been designed to meet the requirements of the quality control standards for an accounting and auditing practice established by the AICPA, and whether it was complied with during the year reviewed to provide the firm with reasonable assurance of conforming with professional standards.
  - g. A description of the reason(s) for any modification of the opinion.
  - h. An opinion on whether the reviewed firm complied with the



**2104            Standards for Performing and Reporting on Peer Reviews**

membership requirements of the SEC Practice Section in all material respects and, if not, a description of the reasons for modification.

- .03 A firm-on-firm report should be issued on the reviewing firm's letterhead and signed in the firm's name. All other reports should be issued on the letterhead of the entity that appointed or formed the review team and should be signed by the team captain on behalf of the review team (without reference to the captain's firm).
- .04 The report should be addressed to the partners, proprietors, stockholders, or officers of the reviewed firm and should be dated as of the date of the exit conference.
- .05 The report should use plurals such as "we have reviewed" — even if the review team consists of only one person. The singular— "I have reviewed"— is appropriate only when the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

**GUIDELINES FOR WRITING MODIFYING PARAGRAPHS**

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

**Report Modified for Design Deficiencies**

- .07 A design deficiency exists when the reviewed firm's quality control policies and procedures, even if fully complied with,

are not designed to meet the requirements of the quality control standards for an accounting and auditing practice established by the AICPA. Deficiencies in the design of a system of quality control would be significant, and a modified report should be issued, if the design of the system created a condition in which the firm did not have reasonable assurance of conforming with professional standards in its accounting and auditing practice during the year being reviewed.

- .08 The reason for the modification should be discussed in a separate paragraph after the standard first three paragraphs. The modifying paragraph should contain —
- a. A description of the nature of the deficiency in the firm's policies and procedures that constitute its system of quality control. (The modifying paragraph should not discuss engagement deficiencies.)
  - b. A statement that the firm was not provided with reasonable assurance of conforming with professional standards on accounting and auditing engagements as a result of the design deficiencies.
  - c. A reference to the letter of comments such as,  
  
"This matter is discussed in more detail in our letter of comments dated . . . "
- .09 The first sentence of the opinion paragraph of the standard report should be revised as follows:
- "In our opinion, except for the deficiency(ies) described in the preceding paragraph, the system of quality control . . ."
- .10 Refer to SECPS §2100.28 for an illustrative report modified for design deficiencies.

**Report Modified for Noncompliance With Quality Control Policies and Procedures**

- .11 In assessing whether the degree of compliance was adequate to provide assurance of conforming with professional standards to the firm, the review team should consider the nature, causes, pattern, and pervasiveness of the instances of noncompliance noted. The review team should consider the implications of the degree of noncompliance for the firm's quality control system as a whole, not only their importance in the specific circumstances in which they were observed. If a review team concludes that the nature, causes, pattern, pervasiveness, or

implications of instances of nonconformity are of such significance - individually or in the aggregate - that the reviewed firm's degree of compliance with its prescribed quality control policies and procedures did not provide it with reasonable assurance of conforming with professional standards, a modified report should be issued.

- .12 The reason for the modification should be discussed in a separate paragraph after the standard first three paragraphs. The modifying paragraph should contain -
- a. A description of the quality control policies and procedures that were not followed (the modifying paragraph should not discuss engagement deficiencies).
  - b. A statement that the firm's policies and procedures were not followed in a manner to provide the firm with reasonable assurance of conforming with professional standards on accounting and auditing engagements.
  - c. A reference to the letter of comments such as,  
  
"This matter is discussed in more detail in our letter of comments dated . . . "
- .13 The first sentence of the opinion paragraph of the standard report should be revised as follows:
- "In our opinion, except for the deficiency(ies) described in the preceding paragraph, the system of quality control ... "
- .14 Refer to SECPS §2100.29 for an illustrative report modified for noncompliance with firm policies and procedures.

**Report Modified for Noncompliance With Membership Requirements**

- .15 The review team should evaluate whether the reviewed firm complied in all material respects with each of the membership requirements of the SEC Practice Section. In evaluating the significance of instances of noncompliance with a membership requirement, the review team should recognize that those requirements directly related to the quality of performance on accounting and auditing engagements usually are more critical.
- .16 If a report is modified only for a failure to comply with one or more of the membership requirements of the section, a separate paragraph need not be added after the standard first three paragraphs. Rather, the last sentence of the opinion paragraph of the standard report should be deleted and the nature and extent of the noncompliance should be reported in

a separate final opinion paragraph such as,

"Also, in our opinion, except, for . . . , the firm has complied with the membership requirements of the Section in all material respects. This matter is discussed in more detail in our letter of comments dated . . . . ."

- .17 The second paragraph of the standard report should not make reference to the letter of comments regardless of the fact that the letter may contain findings on the system of quality control.
- .18 Refer to SECPS §2100.30 for an illustrative report modified for noncompliance with membership requirements.

**Report Modified for a Quality Control System Design Deficiency and Noncompliance With Membership Requirements**

- .19 If a report is modified for a failure to comply with one or more of the membership requirements of the section as well as for a deficiency in the design of the firm's system of quality control or for noncompliance with the firm's system of quality control, all the matters should be described in a separate paragraph after the standard first three paragraphs. The modifying paragraph should contain —
  - a. A brief description of the nature and extent of the deficiencies in the firm's system of quality control. (The modifying paragraph should not discuss engagement deficiencies.)
  - b. A brief description of the nature and extent of the noncompliance with the Section's membership requirements.
  - c. A reference to the letter of comments such as,

"These matters are discussed in more detail in our letter of comments dated . . . . ."
- .20 The opinion paragraph of the standard report should be revised as follows:

"In our opinion, except for the first deficiency described in the preceding paragraph, the system of quality control . . . of complying with professional standards. Also, in our opinion, except for the second deficiency described in the preceding paragraph, the firm has complied with . . ."
- .21 Refer to SECPS §2100.31 for an illustrative report modified for a quality control design deficiency and noncompliance with

membership requirements.

Adverse Report

- .22 The review team should evaluate whether the reviewed firm's system of quality control has been designed to meet the requirements of the quality control standards for an accounting and auditing practice established by the AICPA, was being complied with for the year reviewed and provided the firm with reasonable assurance of conforming with professional standards. If the review team finds there are significant deficiencies in the design of a system of quality control, pervasive instances of noncompliance with the firm's system of quality control as a whole, or both, resulting in several material failures to adhere to professional standards on engagements, an adverse report may be appropriate.
- .23 The reasons for an adverse report should be discussed in a separate paragraph after the standard first three paragraphs. The paragraph should contain —
- a. A brief description of the nature and extent of the deficiencies in the firm's system of quality control and whether the deficiencies were caused by an inappropriately designed system or noncompliance by professional staff.
  - b. A description of the engagement deficiencies, such as,  
  
"In connection with these deficiencies, we noted failures to adhere to professional standards in reporting on material departures from generally accepted accounting principles, in applying generally accepted auditing standards, and in complying with the standards for accounting and review services."
  - c. A reference to the letter of comments such as,  
  
"These matters are discussed in more detail in our letter of comments dated . . . "
- .24 The opinion paragraph of the standard report should be revised as follows:
- "In our opinion, because of the deficiencies described in the preceding paragraph, the system of quality control for the accounting and auditing practice of H. Leonine & Company in effect for the year ended September 30, 19XX, has not been designed to meet the requirements of the quality control standards for an accounting and auditing practice established

by the AICPA, and was not complied with during the year then ended to provide the firm with reasonable assurance of complying with professional standards. Also, in our opinion, the firm has not complied with the membership requirements of the Section in all material respects because it did not meet the requirements of the quality control standards established by the AICPA."

- .25 Refer to SECPS §2100.32 for an illustrative adverse report modified for design deficiencies and noncompliance with the system of quality control.

**ILLUSTRATIVE REPORTS**

- .26 The following paragraphs contain standard illustrative reports as follows:

- Standard Form for an Unmodified Report
- Modified Report for an Engagement Performance Design Deficiency
- Modified Report for Noncompliance With Quality Control Policies and Procedures
- Modified Report for Noncompliance With Membership Requirements
- Modified Report for a Quality Control System Design Deficiency and Noncompliance With Membership Requirements
- Adverse Report

## .27 Standard Form for an Unmodified Report

September 30, 19xx

To the Partners  
Jones, Wilson & Co.

We have reviewed the system of quality control for the accounting and auditing practice of Jones, Wilson & Co. (the firm) in effect for the year ended June 30, 19xx. A system of quality control encompasses the firm's organizational structure and the policies adopted and procedures established to provide it with reasonable assurance of complying with professional standards. The elements of quality control are described in the Statements on Quality Control Standards issued by the American Institute of Certified Public Accountants (the "AICPA"). The design of the system, and compliance with it, are the responsibilities of the firm. In addition, the firm has agreed to comply with the membership requirements of the SEC Practice Section of the AICPA Division for CPA Firms (the Section). Our responsibility is to express an opinion on the design of the system, and the firm's compliance with that system and the Section's membership requirements based on our review.

Our review was conducted in accordance with standards established by the Peer Review Committee of the Section. In performing our review, we obtained an understanding of the system of quality control for the firm's accounting and auditing practice. In addition, we tested compliance with the firm's quality control policies and procedures and with the membership requirements of the Section to the extent we considered appropriate. These tests covered the application of the firm's policies and procedures on selected engagements. *(We also tested the supervision and control of portions of engagements performed outside the United States<sup>1</sup>.)* Because our review was based on selective tests, it would not necessarily disclose all weaknesses in the system of quality control or all instances of lack of compliance with it or with the membership requirements of the Section. *(As is customary in a peer review, we are issuing a letter under this date that sets forth comments relating to certain policies and procedures or compliance with them. These matters were not considered to be of sufficient*

---

<sup>1</sup> To be included for reviewed firms with offices, correspondents or affiliates outside the United States. The wording should be tailored if the reviewed firm's use of correspondents or affiliates within the United States is significant to the scope of the review.

*significance to affect the opinion expressed in this report.<sup>2)</sup>*

Because there are inherent limitations in the effectiveness of any system of quality control, departures from the system may occur and not be detected. Also, projection of any evaluation of a system of quality control to future periods is subject to the risk that the system of quality control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the system of quality control for the accounting and auditing practice of Jones, Wilson & Co. in effect for the year ended June 30, 19xx, has been designed to meet the requirements of the quality control standards for an accounting and auditing practice established by the AICPA, and was complied with during the year then ended to provide the firm with reasonable assurance of complying with professional standards. Also, in our opinion, the firm has complied with the membership requirements of the Section in all material respects.

---

Deary & Company, LLP<sup>3</sup>

---

<sup>2</sup> To be included if the review team issues a letter of comments along with the unmodified report.

<sup>3</sup> The report should be signed by the reviewing firm for firm on firm reviews or by the Team Captain for reviews by committee appointed review teams and reviews by an association-sponsored review team.



.28 Modified Report for an Engagement Performance Design  
Deficiency

September 30, 19xx

To the Partners  
Deary and Company

We have reviewed the system of quality control for the accounting and auditing practice of Deary and Company (the firm) in effect for the year ended June 30, 19xx. A system of quality control encompasses the firm's organizational structure and the policies adopted and procedures established to provide it with reasonable assurance of complying with professional standards. The elements of quality control are described in the Statements on Quality Control Standards issued by the American Institute of Certified Public Accountants (the "AICPA"). The design of the system, and compliance with it, are the responsibilities of the firm. In addition, the firm has agreed to comply with the membership requirements of the SEC Practice Section of the AICPA Division for CPA Firms (the Section). Our responsibility is to express an opinion on the design of the system, and the firm's compliance with that system and the Section's membership requirements based on our review.

Our review was conducted in accordance with standards established by the Peer Review Committee of the Section. In performing our review, we obtained an understanding of the system of quality control for the firm's accounting and auditing practice. In addition, we tested compliance with the firm's quality control policies and procedures and with the membership requirements of the Section to the extent we considered appropriate. These tests covered the application of the firm's policies and procedures on selected engagements. (*We also tested the supervision and control of portions of engagements performed outside the United States<sup>4</sup>.*) Because our review was based on selective tests, it would not necessarily disclose all weaknesses in the system of quality control or all instances of lack of compliance with it or with the membership requirements of the Section.

Because there are inherent limitations in the effectiveness of any system of quality control, departures from the system may occur and not be detected. Also, projection of any evaluation of a system of quality control to future periods is subject to the risk that the system of quality control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

---

<sup>4</sup> See footnote 1.

Our review disclosed that the firm's quality control policies and procedures for engagement performance were not appropriately designed because they do not include appropriate procedures for reviewing accountants' reports and accompanying financial statements in order to provide the firm with reasonable assurance of complying with professional standards on accounting and auditing engagements. This matter is discussed in more detail in our letter of comments dated September 30, 19xx.

In our opinion, except for the deficiency described in the preceding paragraph, the system of quality control for the accounting and auditing practice of Deary and Company in effect for the year ended June 30, 19xx, has been designed to meet the requirements of the quality control standards for an accounting and auditing practice established by the AICPA, and was complied with during the year then ended to provide the firm with reasonable assurance of complying with professional standards. Also, in our opinion, the firm has complied with the membership requirements of the Section in all material respects.

---

Johnson & Company, LLP<sup>5</sup>

---

<sup>5</sup> See footnote 3.

.29 Modified Report for Noncompliance With Quality Control  
Policies and Procedures

September 30, 19xx

To the Partners  
Jackson, Allen and Associates

We have reviewed the system of quality control for the accounting and auditing practice of Jackson, Allen and Associates (the firm) in effect for the year ended June 30, 19xx. A system of quality control encompasses the firm's organizational structure and the policies adopted and procedures established to provide it with reasonable assurance of complying with professional standards. The elements of quality control are described in the Statements on Quality Control Standards issued by the American Institute of Certified Public Accountants (the "AICPA"). The design of the system, and compliance with it, are the responsibilities of the firm. In addition, the firm has agreed to comply with the membership requirements of the SEC Practice Section of the AICPA Division for CPA Firms (the Section). Our responsibility is to express an opinion on the design of the system, and the firm's compliance with that system and the Section's membership requirements based on our review.

Our review was conducted in accordance with standards established by the Peer Review Committee of the Section. In performing our review, we obtained an understanding of the system of quality control for the firm's accounting and auditing practice. In addition, we tested compliance with the firm's quality control policies and procedures and with the membership requirements of the Section to the extent we considered appropriate. These tests covered the application of the firm's policies and procedures on selected engagements. (*We also tested the supervision and control of portions of engagements performed outside the United States<sup>6</sup>.*) Because our review was based on selective tests, it would not necessarily disclose all weaknesses in the system of quality control or all instances of lack of compliance with it or with the membership requirements of the Section.

Because there are inherent limitations in the effectiveness of any system of quality control, departures from the system may occur and not be detected. Also, projection of any evaluation of a system of quality control to future periods is subject to the risk that the system of quality control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

---

<sup>6</sup> See footnote 1.

Our review disclosed that the firm's quality control policies and procedures for partner review of working papers and financial statements were not followed in a manner to provide the firm with reasonable assurance of complying with professional standards on accounting and auditing engagements. This matter is discussed in more detail in our letter of comments dated September 30, 19xx.

In our opinion, except for the deficiency described in the preceding paragraph, the system of quality control for the accounting and auditing practice of Jackson, Allen and Associates in effect for the year ended June 30, 19xx, has been designed to meet the requirements of the quality control standards for an accounting and auditing practice established by the AICPA, and was complied with during the year then ended to provide the firm with reasonable assurance of complying with professional standards. Also, in our opinion, the firm has complied with the membership requirements of the Section in all material respects.

---

Deary & Company, LLP <sup>7</sup>

---

<sup>7</sup> See footnote 3.

**.30 Modified Report for Noncompliance With Membership Requirements**

September 30, 19xx

To the Partners  
St. John, Webster and Associates

We have reviewed the system of quality control for the accounting and auditing practice of St. John, Webster and Associates (the firm) in effect for the year ended June 30, 19xx. A system of quality control encompasses the firm's organizational structure and the policies adopted and procedures established to provide it with reasonable assurance of complying with professional standards. The elements of quality control are described in the Statements on Quality Control Standards issued by the American Institute of Certified Public Accountants (the "AICPA"). The design of the system, and compliance with it, are the responsibilities of the firm. In addition, the firm has agreed to comply with the membership requirements of the SEC Practice Section of the AICPA Division for CPA Firms (the Section). Our responsibility is to express an opinion on the design of the system, and the firm's compliance with that system and the Section's membership requirements based on our review.

Our review was conducted in accordance with standards established by the Peer Review Committee of the Section. In performing our review, we obtained an understanding of the system of quality control for the firm's accounting and auditing practice. In addition, we tested compliance with the firm's quality control policies and procedures and with the membership requirements of the Section to the extent we considered appropriate. These tests covered the application of the Firm's policies and procedures on selected engagements. (*We also tested the supervision and control of portions of engagements performed outside the United States<sup>8</sup>.*) Because our review was based on selective tests, it would not necessarily disclose all weaknesses in the system of quality control or all instances of lack of compliance with it or with the membership requirements of the Section.

Because there are inherent limitations in the effectiveness of any system of quality control, departures from the system may occur and not be detected. Also, projection of any evaluation of a system of quality control to future periods is subject to the risk that the system of quality control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

---

<sup>8</sup> See footnote 1.

In our opinion, the system of quality control for the accounting and auditing practice of St. John, Webster and Associates in effect for the year ended June 30, 19xx, has been designed to meet the requirements of the quality control standards for an accounting and auditing practice established by the AICPA, and was complied with during the year then ended to provide the firm with reasonable assurance of complying with professional standards.

Also, in our opinion, except for the failure to have a partner, other than the partner in charge of an SEC engagement, perform a concurring review prior to the issuance of the audit report on the financial statements of an SEC client, the firm has complied with the membership requirements of the Section in all material respects. This matter is discussed in more detail in our letter of comments dated September 30, 19xx.

---

Deary & Company, LLP<sup>9</sup>

---

<sup>9</sup> See footnote 3.

2118            Standards for Performing and Reporting on Peer Reviews

.31    Modified Report for a Quality Control System Design Deficiency  
and Noncompliance With Membership Requirements

December 20, 19xx

To the Partners  
Busel and Company

We have reviewed the system of quality control for the accounting and auditing practice of Busel and Company (the firm) in effect for the year ended September 30, 19xx. A system of quality control encompasses the firm's organizational structure and the policies adopted and procedures established to provide it with reasonable assurance of complying with professional standards. The elements of quality control are described in the Statements on Quality Control Standards issued by the American Institute of Certified Public Accountants (the "AICPA"). The design of the system, and compliance with it, are the responsibilities of the firm. In addition, the firm has agreed to comply with the membership requirements of the SEC Practice Section of the AICPA Division for CPA Firms (the Section). Our responsibility is to express an opinion on the design of the system, and the firm's compliance with that system and the Section's membership requirements based on our review.

Our review was conducted in accordance with standards established by the Peer Review Committee of the Section. In performing our review, we obtained an understanding of the system of quality control for the firm's accounting and auditing practice. In addition, we tested compliance with the firm's quality control policies and procedures and with the membership requirements of the Section to the extent we considered appropriate. These tests covered the application of the Firm's policies and procedures on selected engagements. (*We also tested the supervision and control of portions of engagements performed outside the United States<sup>10</sup>.*) Because our review was based on selective tests, it would not necessarily disclose all weaknesses in the system of quality control or all instances of lack of compliance with it or with the membership requirements of the Section.

Because there are inherent limitations in the effectiveness of any system of quality control, departures from the system may occur and not be detected. Also, projection of any evaluation of a system of quality control to future periods is subject to the risk that the system of quality control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

---

<sup>10</sup> See footnote 1.

Our review disclosed that the firm's quality control policies and procedures for engagement performance were not appropriately designed because they do not include appropriate procedures for reviewing accountants' reports and accompanying financial statements in order to provide the firm with reasonable assurance of complying with professional standards on accounting and auditing engagements. In addition, the firm failed to have a partner, other than the partner in charge of an SEC engagement, perform a concurring review prior to the issuance of the audit report on the financial statements of an SEC client as required by the membership requirements of the Section. These matters are discussed in more detail in our letter of comments dated December 20, 19xx.

In our opinion, except for the first deficiency described in the preceding paragraph, the system of quality control for the accounting and auditing practice of Busel and Company in effect for the year ended September 30, 19xx, has been designed to meet the requirements of the quality control standards for an accounting and auditing practice established by the AICPA, and was complied with during the year then ended to provide the firm with reasonable assurance of complying with professional standards. Also, in our opinion, except for the second deficiency described in the preceding paragraph, the firm has complied with the membership requirements of the Section in all material respects.

---

Deary & Company, LLP

---

<sup>11</sup> See footnote 3.



.32 Adverse Report

December 20, 19xx

To the Partners  
H. Leonine and Company

We have reviewed the system of quality control for the accounting and auditing practice of H. Leonine and Company (the firm) in effect for the year ended September 30, 19xx. A system of quality control encompasses the firm's organizational structure and the policies adopted and procedures established to provide it with reasonable assurance of complying with professional standards. The elements of quality control are described in the Statements on Quality Control Standards issued by the American Institute of Certified Public Accountants (the "AICPA"). The design of the system, and compliance with it, are the responsibilities of the firm. In addition, the firm has agreed to comply with the membership requirements of the SEC Practice Section of the AICPA Division for CPA Firms (the Section). Our responsibility is to express an opinion on the design of the system, and the firm's compliance with that system and the Section's membership requirements based on our review.

Our review was conducted in accordance with standards established by the Peer Review Committee of the Section. In performing our review, we obtained an understanding of the system of quality control for the firm's accounting and auditing practice. In addition, we tested compliance with the firm's quality control policies and procedures and with the membership requirements of the Section to the extent we considered appropriate. These tests covered the application of the Firm's policies and procedures on selected engagements. (*We also tested the supervision and control of portions of engagements performed outside the United States<sup>12</sup>.*) Because our review was based on selective tests, it would not necessarily disclose all weaknesses in the system of quality control or all instances of lack of compliance with it or with the membership requirements of the Section.

Because there are inherent limitations in the effectiveness of any system of quality control, departures from the system may occur and not be detected. Also, projection of any evaluation of a system of quality control to future periods is subject to the risk that the system of quality control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our review disclosed that the firm's quality control policies and

---

<sup>12</sup> See footnote 1.

procedures for reviews of engagement working papers and reports had not been complied with sufficiently to provide the firm with reasonable assurance of complying with professional standards. In addition, our review disclosed that the firm's quality control policies and procedures for engagement performance were not appropriately designed because they do not provide the firm with reasonable assurance that personnel will seek assistance to the extent necessary from persons having appropriate levels of knowledge, competence, judgment, and authority. In connection with these deficiencies, we noted failures to adhere to professional standards in reporting on material departures from generally accepted accounting principles, in applying generally accepted auditing standards, and in complying with the standards for accounting and review services. These matters are discussed in more detail in our letter of comments dated December 20, 19xx.

In our opinion, because of the deficiencies described in the preceding paragraph, the system of quality control for the accounting and auditing practice of H. Leonine and Company in effect for the year ended September 30, 19xx, has not been designed to meet the requirements of the quality control standards for an accounting and auditing practice established by the AICPA, and was not complied with during the year then ended to provide the firm with reasonable assurance of complying with professional standards. Also, in our opinion, the firm has not complied with the membership requirements of the Section in all material respects because it did not meet the requirements of the quality control standards established by the AICPA.

---

Deary & Company, LLP <sup>13</sup>

[END]

---

<sup>13</sup> See footnote 3.

## SECPS Section 2200

## GUIDELINES FOR AND ILLUSTRATIONS OF THE LETTER OF COMMENTS

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

## TABLE OF CONTENTS

<u>Section</u>	<u>Paragraph</u>
2200 Guidelines for and Illustrations of the Letter of Comments	
Introduction . . . . .	.01
Objectives . . . . .	.02
General Guidelines . . . . .	.03
Matters To Be Included in the Letter of Comments	.04 - .07
Reporting Considerations . . . . .	.08 - .17
Comments Regarding the Design of the Firm's System of Quality Control . . . . .	.08 - .10
Noncompliance With the Firm's System of Quality Control . . . . .	.11 - .16
Noncompliance With Membership Requirements . . . . .	.17
Matters That Should Not Be Included in the Letter of Comments . . . . .	.18 - .23
Apparent Deficiencies in Design or Compliance Wholly or Partially Offset By Other Compensating Policies and Procedures . . . . .	.19
Recommendations Regarding the Firm's Quality Control Document . . . . .	.20 - .21
Isolated Occurrences . . . . .	.22
Administrative Matters . . . . .	.23
Points to Consider When Writing the Letter of Comments . . . . .	.24
General Guidelines for Describing the Review Team's Findings . . . . .	.25 - .29
Illustrative Examples That Might Be Included in the Letter of Comments . . . . .	.30 - .100
Independence, Integrity, and Objectivity . . . . .	.32 - .37
Illustrative Examples of Design Deficiencies	.33 - .35
Illustrative Examples of Compliance Deficiencies . . . . .	.36 - .37
Personnel Management . . . . .	.38 - .51
Illustrative Examples of Design Deficiencies	.39 - .47

## TABLE OF CONTENTS

<u>Section</u>	<u>Paragraph</u>
Illustrative Examples of Compliance Deficiencies . . . . .	.48 - .51
Acceptance and Continuance of Clients and Engagements . . . . .	.52 - .60
Illustrative Examples of Design Deficiencies Illustrative Examples of Compliance Deficiencies . . . . .	.53 - .57 .58 - .60
Engagement Performance . . . . .	.61 - .83
Illustrative Examples of Design Deficiencies Illustrative Examples of Compliance Deficiencies . . . . .	.62 - .74 .75 - .83
Monitoring . . . . .	.84 - .95
Monitoring Procedures . . . . .	.85
Illustrative Examples of Design Deficiencies Illustrative Examples of Compliance Deficiencies . . . . .	.86 - .89 .90 - .95
SECPS Membership Requirements . . . . .	.96 - .100
2200      Appendixes	
A-Sample Letter of Comments for the SECPS Peer Review Program . . . . .	.101
B-Checklist for Reviewing Drafts of Letters of Comments . . . . .	.102
C-Examples of Poorly Written Letter of Comments Items . . . . .	.103 - .109
D-Guidance for Determining Whether a Finding Appeared in the Letter Issued in Connection With a Prior Peer Review . . .	.110 - .112
E-Case Studies on Writing Letters of Comments	.113 - .119

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

- .01 The criterion for including an item in the letter of comments is whether the item resulted in a condition being created in which there was more than a remote possibility that the firm would not conform with professional standards on accounting and auditing engagements.<sup>1</sup> Because this is a very low threshold, most peer reviews result in the issuance of a letter of comments.

**OBJECTIVES**

- .02 The major objectives of the letter are to—
- a. Report matters (including the matters, if any, that resulted in a modified report) that the review team believes resulted in conditions being created in which there was more than a remote possibility that the firm would not conform with professional standards on accounting and auditing engagements, and to set forth recommendations regarding those matters.
  - b. Provide information about the effectiveness of the firm's system of quality control.
  - c. Provide those responsible for oversight with information necessary to evaluate the appropriateness of deficiencies in the letter of comments. The letter of comments should also assist those responsible for oversight in determining if the planned actions the reviewed firm has proposed in its letter of response appear appropriate in the circumstances.
  - d. Provide the firm with recommendations to assist the firm in implementing policies and procedures to meet the requirements of the quality control standards for an accounting and auditing practice established by the AICPA.

**GENERAL GUIDELINES**

- .03 The letter should be addressed, dated, and signed in the same manner as the report. It should include—

---

<sup>1</sup> "Remote" has the same meaning in this guide as in Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies* in which "remote" is defined as "slight."

**2204 Standards for Performing and Reporting on Peer Reviews**

- a. A reference to the report indicating if it was modified.
- b. A statement that the matters discussed in the letter were considered in determining the opinion on the system of quality control.
- c. The reviewer's findings and recommendations.

**MATTERS TO BE INCLUDED IN THE LETTER OF COMMENTS**

- .04 The letter of comments should include comments, as described below, regarding the design of the reviewed firm's system of quality control, or its compliance or documentation of its compliance with that system or with the membership requirements. In addition, if a modified peer review report (including adverse reports - see §2100.01) is issued, the letter should include a section on the matters that resulted in the modification. This section would ordinarily include an elaboration of the findings discussed in the modifying paragraph of the report.
- .05 To give appropriate consideration to the evidence obtained and to reach conclusions regarding the matters to be included in the letter of comments, the review team must understand the elements of quality control and exercise professional judgment. The exercise of professional judgment is essential because the significance of the evidence obtained during the review must be evaluated qualitatively and not primarily on a quantitative basis. Reviewers should take the necessary time to investigate findings and understand the underlying cause of the finding from the perspective of the system of quality control.
- .06 The review findings should be based on professional standards and not on personal preferences. Reviewers are occasionally surprised to find that some "generally accepted" professional standards are, in reality, only a preferred treatment by their firm.
- .07 If any of the matters to be included in the letter were included in the letter issued in connection with the firm's last peer review, that fact ordinarily should be noted<sup>2</sup>. The letter may also include comments concerning actions taken by the reviewed firm.

---

<sup>2</sup> See Appendix D, SECPS §2200.110, "Guidance for Determining Whether a Finding Appeared in the Letter Issued in Connection with a Prior Peer Review", for additional guidance and examples for determining the existence of repeat findings.

REPORTING CONSIDERATIONS

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

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

Noncompliance With the Firm's System of Quality Control

- .11 The best system of quality control can only be effective when the firm complies with that system. Although firms have good intentions of following their systems of quality control, other factors, such as lack of communication within the firm, lack of understanding of the system, and complacency, can cause compliance problems.
- .12 Instances of noncompliance with significant firm policies or procedures, either because of a lack of performance or a lack of adequate documentation of performance, should be included in the letter whenever the degree of such noncompliance created a condition in which there was more than a remote possibility that the firm would not conform with professional standards on accounting and auditing engagements, even though the degree of noncompliance was not such as to warrant a modified report.
- .13 Documentation deficiencies are deficiencies in which the reviewer has become convinced, through discussions with the members of the engagement team or other appropriate means, that the engagement team is knowledgeable about the matter under discussion and that the work in question was performed, but was not documented sufficiently in the working papers.

- .14 In assessing whether the degree of noncompliance created a condition in which there was more than a remote possibility that the firm would not conform with professional standards on accounting and auditing engagements, the review team should consider the **nature, causes, pattern, and pervasiveness** of the instances of noncompliance noted, and also the implications for the firm's system of quality control as a whole, not merely the importance in the specific circumstances in which the instances were observed. To do this, the review team should evaluate the instances of noncompliance, both individually and collectively, recognizing that adherence to certain policies or procedures is more critical to assuring conformity with professional standards than adherence to others. Accordingly, a higher degree of compliance should be expected for the more critical policies and procedures. However, noncompliance with quality control policies and procedures that are less critical to assuring conformity with professional standards may also be reportable in a letter of comments. For example, a higher degree of noncompliance with a personnel management policy for hiring relative to the obtaining of background information might be more tolerable than noncompliance with an engagement performance policy that requires an independent partner to review the report and accompanying financial statements before issuance of the report.
- .15 When engagement deficiencies—particularly instances of nonconformity with professional standards—were attributable to instances of noncompliance with significant firm policies or procedures described in the letter, that information ordinarily should be included in the description of the finding.
- .16 When the nature and degree of noncompliance at one or more offices of a multioffice firm or other significant practice segments were of such significance that a condition was created in which there was more than a remote possibility that the office would not conform with professional standards on accounting and auditing engagements, the review team should consider whether the matter should be included in the letter of comments, even though the degree of compliance for the remainder of the firm did not create such condition with respect to the firm as a whole. In these instances, the identity of the office should not be revealed in the letter of comments.



Noncompliance With Membership Requirements

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

MATTERS THAT SHOULD NOT BE INCLUDED IN THE LETTER OF COMMENTS

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

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

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

Recommendations Regarding the Firm's Quality Control Document

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

Isolated Occurrences

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

Administrative Matters

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

POINTS TO CONSIDER WHEN WRITING THE LETTER OF COMMENTS

- .24 The objectives of the letter of comments are more likely to be met when the letter is written in a clear, concise manner. The following points should be considered when writing a letter:
- a. If a modified (adverse) report is issued, the letter should be divided into two sections: (1) Matters that resulted in a modified (adverse) report, and (2) Matters that did not result in a modified (adverse) report. However, if the report is not modified (adverse), do not include the phrase "matters that did not result in a modified (adverse) report."
  - b. Use the format recommended in this section of "Findings" and "Recommendations." Separate, clearly captioned paragraphs should be used to report the findings and related recommendations.

- c. Include headings for each quality control element for which there is a comment.
- d. Items included in the letter should have a "systems" orientation. That is to say, identify the underlying weakness in the system of quality control that caused a particular engagement deficiency to occur. The finding should not just describe the engagement deficiency.
- e. Identify the likely causes of the deficiencies (for example, describe the deficiencies as either design deficiencies or compliance deficiencies [performance or documentation]).
- f. Group findings caused by the same deficiency into a single comment. For example, if the review team notes various disclosure deficiencies caused by the failure to use a disclosure checklist or to perform other appropriate procedures, a single comment on the cause of all the disclosure deficiencies is preferable to numerous comments on individual deficiencies. The letter should not list each disclosure deficiency noted by the review team.
- g. Do not group unrelated findings into one comment. For example, disclosure deficiencies should be separated from comments regarding insufficient documentation unless they relate to the same quality control deficiency.
- h. Describe the findings completely, but avoid excessive or redundant detail in the letter of comments.
- i. Use general terms to indicate frequency of occurrence. Terms such as "in some instances" or "frequently" are preferable to the specific number of instances.
- j. Do not identify specific engagements, individuals, or offices by name or otherwise. For example, do not refer to the firm's SEC engagement.
- k. Do not include personal preferences in the letter when they relate to procedures (such as engagement letters or time budgets) that are not required by the firm's system of quality control, and are not essential to the reviewed firm's conformity with professional standards on accounting and auditing engagements. Such matters may be communicated to the firm orally.
- l. Avoid references to specific technical standards, where possible. In most instances, a general reference to

"professional standards" will suffice. If a reference to a specific technical standard is necessary, always include a complete description of the topic to which it relates.

- m. When a finding describes a performance deficiency where the firm may have departed from professional standards, include a sentence advising the reader whether additional actions are necessary on the engagement reviewed ("close the loop"). If corrective actions are necessary, a description of the actions taken or planned by the reviewed firm should be included. Ordinarily, the reviewer need not "close the loop" for documentation deficiencies.
- n. Use general terms when referring to purchased practice aids, instead of the names of specific vendors.
- o. If any of the matters to be included in the letter of comments were included in the letter issued in connection with the firm's last peer review, this fact should be noted in describing the matter. In this regard, comments should not be written in such a general manner that they may be "automatically repeated" in the documents issued with the firm's next review.<sup>3</sup>
- p. Be careful not to overemphasize the use of standardized forms and checklists as a recommendation for improving the firm's system of quality control. Although forms and checklists may be helpful in many circumstances, their use will not cure all deficiencies. Think carefully about the cause of the deficiency and whether a different recommendation would provide a more effective cure.
- q. Have a person in your firm unfamiliar with the findings on the review read the letter of comments before it is finalized. Ask the person whether he or she understands the findings and recommendations *without asking any questions*.

#### **GENERAL GUIDELINES FOR DESCRIBING THE REVIEW TEAM'S FINDINGS**

- .25 In describing a deficiency in the design of the reviewed firm's system or instances of noncompliance, the findings ordinarily can be described in the following manner:
  - a. *Design deficiency*—(1) State what the system does or does

---

<sup>3</sup> See footnote 2.

not require; (2) if appropriate, state whether engagement deficiencies—particularly those that caused the reviewers to conclude that the reviewed firm (a) should consider taking action pursuant to the Statement on Auditing Standards (SAS) No. 46, *Consideration of Omitted Procedures After the Report Date* (AICPA, Professional Standards, vol. 1, AU sec. 390) and SAS No. 1 (AICPA, Professional Standards, vol. 1, AU sec. 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report*) or (b) lacked a reasonable basis under the standards for accounting and review services for the reports issued—were attributable to the design deficiency; and (3) describe the effect, if any, that the deficiency had on the financial statements issued.

- b. *Instances of noncompliance (performance or documentation)*—(1) State what the system requires; (2) state the frequency of noncompliance in general terms; (3) if appropriate, state whether engagement deficiencies—particularly those that caused the reviewers to conclude that the reviewed firm (a) should consider taking action pursuant to the AICPA Professional Standards, vol. 1, AU sections 390 and 561, or (b) lacked a reasonable basis under the standards for accounting and review services for the reports issued—were attributable to the instances of noncompliance; and (4) describe the effect, if any, that the instances of noncompliance had on the financial statements issued.

.26 Under the above guidelines—

- a. A good way to start a letter of comment finding would be with the following words: "The firm's quality control policies and procedures...." Then state what the system does or does not require. This informs the reader of the status of the system of quality control.
- b. The second sentence of the finding would explain the result, such as "As a result...." or "However, the firm did not always comply with these policies and as a result...."
- c. The last sentence should "close the loop" if the finding relates to an engagement performance deficiency. Some examples of "closing the loop" are:
- None of the missing or incomplete disclosures represented significant departures from professional standards.

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

- None of the missing disclosures were of such significance to make the financial statements misleading.
  - We noted financial statements that did not include all of the disclosures required by generally accepted accounting principles, and, in one instance, financial statements that were materially misstated. The report on the latter financial statements has been recalled, and the financial statements are being revised.
  - We were satisfied that the firm performed the necessary procedures even though they were not documented sufficiently.
  - We found an engagement in which, because of a lack of involvement by the engagement partner in planning the audit, the work performed on the existence of receivables and inventory did not appear to support the firm's opinion on the financial statements. As a result of this finding, the firm performed the necessary additional procedures to provide a satisfactory basis for its opinion.
- .27 Appendix A illustrates how the foregoing matters may be covered in a letter of comments under the SECPS Peer Review Program.
- .28 Appendix B contains a checklist for reviewing drafts of letters of comments.
- .29 Appendix C contains illustrative examples of poorly written letter of comments items.

**ILLUSTRATIVE EXAMPLES THAT MIGHT BE INCLUDED IN THE LETTER OF COMMENTS**

- .30 The rest of this section contains illustrative examples of items that might be included in letters of comments.
- .31 A reviewer must evaluate whether the reviewed firm's system meets the requirements of the quality control standards for an accounting and auditing practice established by the AICPA and whether the system was being complied with to provide the firm with reasonable assurance of conforming with professional standards. By considering the nature, cause, pattern, and pervasiveness of a particular deficiency or group of deficiencies, a reviewer will decide whether a peer

review report should be modified (including adverse reports - see §2100.01), or a matter should be included in a letter of comments, communicated orally, or not communicated at all, based on—

- a. The extent to which the system is designed to meet the requirements of the quality control standards for an accounting and auditing practice established by the AICPA.
- b. The instances of noncompliance with the policies and procedures established by the firm.

As a result, some examples may warrant the issuance of a modified (including adverse reports - see §2100.01) report in certain circumstances, while an unmodified report will be appropriate in other situations with the matter being included in the letter of comments or communicated orally.

*Independence, Integrity, and Objectivity*

- .32 The objective of the *Independence, Integrity, and Objectivity* element of a system of quality control is to provide the firm with reasonable assurance that personnel maintain independence (in fact and in appearance) in all required circumstances, perform all professional responsibilities with integrity, and maintain objectivity in discharging professional responsibilities.

*Illustrative Examples of Design Deficiencies*

- .33 *Finding*—The firm's policies and procedures for independence, integrity, and objectivity have been appropriately communicated to the firm's professional personnel through its quality control document and through training programs. However, the firm's policies and procedures do not require that professional personnel be informed of all new accounting and auditing clients or engagements on a timely basis. Still, the firm has informed us that its independence has not been impaired on any accounting and auditing engagements.

*Recommendation*—The firm should periodically communicate in writing to all personnel new accounting and auditing clients or engagements accepted by the firm. This communication should also request that any personnel with a possible independence problem with respect to the new engagements or clients contact the administrative partner immediately.

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

Recommendation— We recommend that the firm's quality control policies and procedures be revised to require that a written independence representation be obtained from other firms engaged to perform segments of an accounting and auditing engagement when the firm is acting as the principal auditor.

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

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

#### *Illustrative Examples of Compliance Deficiencies*

- .36 Finding—The firm's quality control policies and procedures require that written independence representations be obtained annually from all partners and professional staff. During our review, we noted that several of the firm's professional staff had failed to sign such a representation. Written independence representations were subsequently obtained and no instances were noted where the firm was not independent with respect to the financial statements on which it reported.

Recommendation—We recommend that the firm comply with its policy of obtaining annual independence representations from all professional personnel, and that compliance with this policy be monitored by the managing partner of the firm. In addition, the firm should highlight this matter during its



inspection procedures.

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

Recommendation—To prevent the recurrence of the above situation, we recommend that the firm's partners periodically review the list of clients with past due fees. In this review, the partners should consider when subsequent work for the client can be performed and if the report on the financial statements can be issued.

#### Personnel Management

- .38 The objective of the *Personnel Management* element of a system of quality control is to provide the firm with reasonable assurance that all personnel have the proficiency to perform their assigned responsibilities. Attributes or qualities that enhance the proficiency of personnel include: integrity, objectivity, intelligence, competence, experience, and motivation when performing, supervising, or reviewing work.

#### *Illustrative Examples of Design Deficiencies*

- .39 Finding<sup>4</sup>—The firm's quality control policies and procedures require that new employees possess certain specified qualifications. However, the hiring policies do not require that the firm document its hiring decisions and the basis thereof. As a result, the personnel files did not always contain sufficient evidence confirming that the individuals hired possess the required qualifications.

Recommendation—We recommend that the firm revise its quality control policies and procedures to require hiring decisions be documented. The nature of the documentation may vary; however, at a minimum, it should document whether an

---

<sup>4</sup> This example may not be applicable for smaller firms that have ongoing monitoring and involvement of senior personnel of the firm with respect to this aspect of their personnel management policy of quality control.

individual meets the stated qualifications and, if not, why it is acceptable to deviate from the firm's stated hiring criteria.

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

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

- .41 Finding—The firm's quality control policies and procedures do not require that the person responsible for assigning personnel to engagements consider specialized industry experience or expertise when assigning all levels of personnel to engagements. We noted that the firm relies primarily on the engagement partner's background and knowledge and does not give adequate consideration to the complexity or other requirements of the engagement when assigning other engagement personnel. On several engagements, we noted instances in which certain personnel did not have sufficient experience, expertise, or training in the areas assigned to them. As a result, the firm did not properly report on several financial statements in a specialized industry. The firm has appropriately recalled and reissued all of the reports.

Recommendation—The firm should revise its quality control policies and procedures to require that personnel assigned to engagements have sufficient experience or expertise to perform the work assigned to them. When it is necessary to assign a person who does not have sufficient experience or expertise to perform a key role on an engagement, the engagement partner should be required to document how the engagement team will compensate for this lack of experience or expertise.

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

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

.43 Finding—The firm's quality control policies and procedures require that professional staff participate in a minimum of forty hours of continuing professional education courses each educational year. The firm's policies also require the administrative partner to compile, at the end of each educational year, a summary of professional education courses in which each professional participated. The policies and procedures do not require that the files be maintained during the period or that the files be reviewed periodically to determine whether the staff is in compliance with the firm's requirements. During our review, we noted a few individuals who had not participated in the required amount of continuing professional education courses during the year under review and were unable to make up the deficiency during the two-month grace period that followed the education year-end.

Recommendation—We recommend that the firm revise its quality control policies and procedures to require that the administrative partner maintain current professional development records and that he or she review these records periodically to determine whether the professional staff is complying with the firm's policies.

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

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

- a. Sponsoring organization
- b. Location of the program by city and state
- c. Title of program, description of content or both
- d. Dates attended or completed
- e. Continuing professional education hours claimed

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

Recommendation—The firm's professional education director should identify and monitor those individuals participating in governmental engagements to ensure that the continuing professional education requirements of *Government Auditing Standards* are met.

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

Recommendation—The firm should revise its quality control procedures and policies to require firm personnel to participate in an appropriate amount of accounting and auditing continuing professional education courses in the

industry areas in which the firm practices.

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

Recommendation—We recommend that the firm establish and document the qualifications necessary for each level of responsibility, including advancement to the next higher level of responsibility, and create a review structure indicating who will prepare evaluations and when they will be prepared, to ascertain that personnel meet the firm's requirements before they are promoted.

#### *Illustrative Examples of Compliance Deficiencies*

- .48 Finding—The firm's quality control policies for hiring require that certain background information be obtained relative to the qualifications of prospective employees (including resumes, applications, college transcripts, and references). During our review, we noted numerous instances in which the personnel files for professional staff hired other than through the firm's college campus recruiting program did not contain evidence that the individual met the firm's stated qualifications.<sup>5</sup>

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

- .49 Finding—The firm's quality control policies and procedures require that engagement partners evaluate planning schedules to ensure that the personnel assigned to an engagement have sufficient experience or expertise to perform the work assigned to them. However, on some engagements reviewed, the personnel below the partner level did not appear to have adequate experience, expertise, or training to perform their work. As a result, certain procedures were not performed adequately. The firm has considered the requirements of professional standards on the engagements, and has determined

---

<sup>5</sup> See footnote 4.

that sufficient procedures had been performed in other areas to support the reports issued on the financial statements.

Recommendation—The firm should adhere to its quality control policies and procedures requiring that when a person who does not have sufficient experience, expertise, or training is assigned a key role on an engagement, the engagement partner is to develop and document an action plan on how the engagement team will compensate for this lack of experience, expertise, or training.

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

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

- .51 Finding—The firm's quality control policies and procedures require that all professional personnel who spend more than a specified amount of time working on an accounting and auditing engagement should receive a written evaluation of their performance in a timely manner. During our review, we determined that such evaluations were not being completed in many instances and that several evaluations which were completed were not prepared timely.

Recommendation—The firm should comply with its policies and procedures requiring the completion of evaluations promptly for personnel performing accounting and auditing engagements. The firm should also monitor the preparation and communication of these evaluations during the completion phase of each engagement in accordance with its policies and procedures. The firm should designate an individual on each engagement whose responsibility would be to determine the evaluations that should be prepared to identify those which have not been prepared.

#### Acceptance and Continuance of Clients and Engagements

- .52 The objective of the *Acceptance and Continuance of Clients and Engagements* element of a system of quality control is to establish criteria for deciding whether to accept or continue a client relationship and whether to perform a specific engagement for that client. Such policies and procedures

should provide the firm with reasonable assurance that (a) the likelihood of associations with a client whose management lacks integrity is minimized, (b) the firm undertake only those engagements that can be completed with professional competence, (c) the risks associated with providing professional services in particular circumstances are appropriately considered, and (d) an understanding with the client regarding the services to be performed is reached.

*Illustrative Examples of Design Deficiencies*

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

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

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

Recommendation—The firm's quality control policies and procedures should be revised to require documentation of its acceptance and continuance procedures and decisions. The firm should revise and implement client acceptance and continuance forms to ensure that all appropriate factors, such as inquiries with the client's attorneys, bankers, and predecessor accountant, are considered in each case.

.55 Finding—The firm's quality control policies and procedures require evaluation of prospective clients for approval before acceptance as clients. However, the firm does not have specific procedures for acceptance of an engagement for existing or prospective clients in a specialized industry for which it does not have the necessary industry expertise. During our review, we noted an instance when the firm accepted an engagement in a specialized industry although it

had no experience or expertise in that industry and it did not update its library to include reference materials related to that area of practice. As a result, certain industry-specific audit procedures were not performed on the engagement. The firm has subsequently performed the omitted audit procedures to support the audit opinion issued.

Recommendation—The firm should revise its quality control policies and procedures for client acceptance to require that, when an engagement is accepted in a specialized industry for which the firm has no experience or expertise, a specific action plan be developed and documented for obtaining the necessary industry expertise. The firm should not perform engagements in specialized industries unless it obtains the appropriate experience or expertise. This matter should be emphasized during the firm's next inspection procedures.

- .56 Finding—The firm's policies and procedures regarding acceptance and continuance of clients and engagements do not require the firm to evaluate whether to perform a specific engagement for an existing client, specifically if the level of service previously provided is changed. As a result, the firm does not always evaluate whether the engagement should be performed by the firm. During our review, we noted an instance where the firm had previously reported on compiled financial statements of a client. The current engagement included reporting on audited financial statements. The firm had no previous experience in conducting audits in the industry. As a result, the firm did not perform certain audit procedures as required by professional standards. The firm has subsequently performed the audit procedures to support its audit opinion on the financial statements.

Recommendation—We recommend that the firm revise its quality control procedures for client acceptance to include an evaluation by the firm for all instances when the level of service changes on an existing client. The firm should consider such factors as firm experience or expertise in both the level of service to be provided and the industry in which the client operates.

- .57 Finding—The firm's policies and procedures regarding client and engagement acceptance do not identify procedures to be followed when engaged by the client to provide new services. During our review we noted one instance on an audit engagement where the firm was asked to perform an attestation engagement on prospective financial statements. Our review disclosed that this was the only attestation engagement performed by the firm. As a result, the firm issued an



inappropriate report on the prospective financial statements. The firm has subsequently recalled and reissued its report on the prospective financial statements.

Recommendation—The firm should revise its policies and procedures regarding acceptance and continuance of clients and engagements to ensure that the firm has both the knowledge and expertise necessary to perform the engagement in an area that is new to the firm.

*Illustrative Examples of Compliance Deficiencies*

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

Recommendation—The firm should comply with its quality control policies and procedures by periodically evaluating its existing clients in accordance with the criteria set forth in its quality control document. The firm should also document such evaluations and decisions as required by firm policy, possibly by using a standardized form.

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

Recommendation—To make sure that all appropriate facts are considered when accepting a new client, the firm should document its considerations and conclusions by completing the new client acceptance form for each new client, and the firm administrator should create and maintain a new client file.

- .60 Finding—The firm's quality control policies and procedures require that the managing partner approve changes in levels of services provided to existing clients. During our review, we noted that on several engagements the level of service had changed from a review to an audit. Approval for this change by the managing partner was not documented in either

the working papers of the client or the administrative files of the firm. During our review of the engagement, we did not note any significant departures from professional standards as a result of this deficiency.

Recommendation—The firm should comply with its quality control policies and procedures by evaluating its acceptance and continuance of clients and engagements with special emphasis on those clients where the level of service provided to the client has changed. In all such instances the approval of both the engagement and managing partners should be documented.

### Engagement Performance

- .61 The objective of the *Engagement Performance* element of a system of quality control is to provide the firm with reasonable assurance that the work performed by engagement personnel meets the applicable professional standards, regulatory requirements, and the firm's standards of quality. Policies and procedures for engagement performance encompass all phases of the design and execution of the engagement. To the extent appropriate and as required by applicable professional standards, these policies and procedures should cover planning, performing, supervising, reviewing, documenting, and communicating the results of each engagement. Policies and procedures should also provide that personnel refer to authoritative literature or other sources and consult, on a timely basis, with individuals within or outside the firm, when appropriate.

### *Illustrative Examples of Design Deficiencies*

- .62 Finding—The firm's quality control policies and procedures require that the engagement partner review the firm's reports and the accompanying financial statements before issuance. However, on several engagements reviewed, the financial statements were not reviewed by the engagement partner and did not include all the disclosures required by generally accepted accounting principles, particularly in related party transactions and leases. None of the missing disclosures were of such significance to make the financial statements misleading.

Recommendation—The firm should revise its quality control policies and procedures for ensuring that clients' financial statements include all relevant disclosures. This could be accomplished by obtaining or developing comprehensive reporting and disclosure checklists and requiring that these checklists be completed by a member of the engagement team,

reviewed by the engagement partner, and retained with the engagement working papers.

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

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

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

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

- .65 Finding—The firm requires that its model audit program be used on all audit engagements. However, the firm does not require that this program be tailored to cover the requirements of specialized industries, when necessary. As a result, our review of engagements disclosed that certain industry-specific audit procedures were not performed. The

firm has subsequently performed the omitted procedures to support the audit opinion issued.

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

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

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

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

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

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

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

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

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

- .70 Finding—The firm's quality control policies and procedures for reviewing accountants' reports and financial statements before issuance are not adequately designed to ensure compliance with professional standards. During our review, we noted that on several compilation and review engagements the accountant's report did not describe what responsibility, if any, the accountant was taking regarding accompanying supplementary information. Also, we found some occasions where the supplementary information was not referenced to the accountant's report. In all cases, supporting working papers were present to indicate an appropriate level of service had been performed on the supplementary information. The firm's inspection program did identify this situation and use of a disclosure checklist was implemented subsequent to the year under review.

Recommendation—Although not required by professional standards, the firm should consider the implementation and use of reporting and disclosure checklists on all engagements. Continued monitoring of the use of these disclosure checklists through inspection procedures will help ensure adherence to the firm's quality control standards.

.71 Finding—The firm's quality control policies and procedures require the engagement partner to review the accountants' or auditors' reports and accompanying financial statements before issuance. During our review, we noted instances where the accountant's reports did not report on supplementary data included in the financial statements. In addition, an auditor's report prepared on a basis prescribed by a regulatory agency did not include the appropriate wording required by professional standards. None of the reporting deficiencies were of such significance as to require additional action by the firm.

Recommendation—The firm should establish a mechanism to assist partners in reviewing auditors' reports and accompanying financial statements, such as requiring staff to use a comprehensive reporting checklist. The engagement partner can then review the checklist prior to issuance of the accountant's or auditor's reports.

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

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

.73 Finding—Our review disclosed that the firm's quality control policies and procedures do not provide procedures for resolving differences of opinion between engagement personnel and specialists. We noted no instances in which differences of opinion on practice problems had not been resolved to the satisfaction of all the parties involved, even though the individuals indicated that they did not have a clear understanding of the firm's policies to be followed in such circumstances.

Recommendation—We recommend that the firm revise its quality control policies and procedures to describe the procedures

for resolving differences of opinion between engagement personnel and specialists. These procedures should then be communicated through the firm's quality control document to all professional personnel.

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

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

#### *Illustrative Examples of Compliance Deficiencies*

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

Recommendation—The firm should discuss at a staff training session its engagement performance policy to use standard programs to review EDP controls. All partners should be advised to monitor compliance with this policy when reviewing audit working papers. Further, the firm should add a step to its planning checklist to ensure that EDP programs have been completed.

- .76 Finding—On several of the engagements reviewed, we noted that a concurring review by a partner having no other responsibility for the engagement, required by firm policy, had not been performed. On these engagements, we noticed that several disclosures required by generally accepted accounting principles were omitted from the financial statements.

However, none of the missing disclosures were of such significance to make the financial statements misleading.

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

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

Recommendation—The firm should hold a training session for all professionals on the matters to be considered and documented when planning an audit engagement. In addition, the firm may consider obtaining or developing a planning checklist to assist staff in planning an audit engagement and documenting the results thereof.

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

Recommendation—The firm should discuss in a staff meeting the importance of adhering to professional standards regarding documentation of communication of reportable conditions to client management. In addition, the firm should also update its audit programs to include a step on documenting the communication of reportable conditions in the working papers.

- .79 Finding—The firm's quality control policies and procedures require completion of a reporting and disclosure checklist and a partner review of the firm's reports and accompanying financial statements prior to issuance. However, on several engagements reviewed, we noted inappropriate answers on these



checklists. As a result, several financial statements did not include all the disclosures required by generally accepted accounting principles in such areas as concentrations of credit risk and related party transactions. None of the missing disclosures were of such significance as to make the financial statements misleading.

Recommendation—The partners of the firm should carefully review the report and disclosure checklist as part of the final financial statement review. In addition, a training session should be held to review with the staff the questions on the financial statement reporting and disclosure checklist.

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

Recommendation—We recommend that the firm discuss the importance of documenting consultations in a staff training session. The firm should consider requiring that the documentation is reviewed and approved by the person consulted.

- .81 Finding—The firm's quality control policies and procedures identify situations where, because of the nature or complexity of the subject matter, consultation ordinarily is needed. During our review, we noted a few instances where the firm appropriately consulted with outside sources; however, they failed to reconcile a difference between the advice of the outside source and the requirements of professional standards. As a result, the firm did not issue certain reports required in a regulated industry. Subsequent to the peer review, the firm issued those reports.

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

- .82 Finding—The firm's quality control policies and procedures state that when experience is not available within the firm to resolve a practice question or problem, engagement personnel should consult with the AICPA or the state CPA

society. Our review disclosed an instance where the firm did not have the experience required and did not consult with the AICPA or the state CPA society as required by firm policy. In this instance, a partner designated as a specialist in another industry was consulted, but the advice rendered resulted in the misapplication of a generally accepted accounting principle. Since the amount involved did not make the financial statements misleading, the firm did not have to recall its report; the client has agreed, however, to adjust the financial statements in the next period in which they are prepared.

Recommendation—We recommend that the firm discuss at a staff training session the importance of consulting the appropriate resources and that, when those resources are not available internally, an outside one should be contacted. In addition, designated specialists within the firm should be reminded that they should not exceed their authority in consultative situations by providing advice in areas outside their expertise.

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

Recommendation—We recommend the firm revise its quality control policies and procedures to require the engagement partners, concurring partners, or both to affirm specifically that consultation occurred in all situations where it is required by firm policy or otherwise warranted. In addition, the firm should discuss at a staff training session its policies regarding consultation as outlined in its quality control document. The firm should encourage its staff to consult with or use authoritative sources on complex or unusual matters in accordance with firm policy.

### Monitoring

- .84 The objective of the *Monitoring* element of a system of quality control is to provide the firm with reasonable assurance that the policies and procedures relating to the

other elements of quality control are suitably designed and being effectively applied. Monitoring is an ongoing consideration and evaluation process.

### ***Monitoring Procedures***

- .85 Statement on Quality Control Standards (SQCS) No. 3, *Monitoring a CPA Firm's Accounting and Auditing Practice* (AICPA, Professional Standards, vol. 2, QC sec. 30) states —

Monitoring procedures taken as a whole should enable the firm to obtain reasonable assurance that its system of quality control is effective. Procedures that provide the firm with a means of identifying and communicating circumstances that may necessitate changes to or the need to improve compliance with the firm's policies and procedures contribute to the monitoring function.

### ***Illustrative Examples of Design Deficiencies***

- .86 Finding—As part of its monitoring procedures, the firm requires preissuance reviews of each report, the accompanying financial statements, and the related working papers for engagements in specialized industries by both the engagement partner and a partner who is not associated with the engagement. However, the firm does not monitor performance on engagements in other industries of its practice.

Recommendation— The firm should revise its quality control policies and procedures to make sure preissuance reviews encompass engagements in each industry in which the firm practices and monitor compliance with the firm's policies and procedures through periodic inspections on these engagements.

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

Recommendation—The firm should revise its quality control policies and procedures to include technical expertise and relevant specialized industry knowledge as a criteria in selecting inspectors. In doing so, the firm will assure it has access to the necessary expertise if inspection findings require corrective actions.

2234            **Standards for Performing and Reporting on Peer Reviews**

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

Recommendation—The firm should revise its quality control policies and procedures to require the preparation of an inspection memorandum summarizing findings, indicating recommended corrective actions, and setting timetables for completing the corrective actions. At a minimum, the memorandum should be distributed to key management personnel and a partner should be designated to monitor the firm's compliance with the policy.

.89    Finding—The firm's quality control policies and procedures provide for a postissuance review of engagements to serve as one of its monitoring procedures to provide evidence that the firm's system of quality control is suitably designed. However, we noted that the firm's policy does not identify a mechanism for timely communication to the firm's personnel regarding any findings resulting from the monitoring procedures.

Recommendation—The firm should develop a procedure to ensure that all staff are informed timely of the results of the monitoring procedures, appropriate actions are planned to implement corrective measures, and appropriate personnel charged with the responsibility of ensuring the planned actions are taken.

***Illustrative Examples of Compliance Deficiencies***

.90    Finding—The firm's quality control policies and procedures require that findings on engagement reviews be summarized so that management can consider what types of corrective actions, if any, are necessary. However, the firm did not summarize inspection findings from engagement reviews from the most recent inspection procedures, even though each engagement partner considered and responded to findings for his or her individual engagements.

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

- .91 Finding—The firm's quality control document requires that inspection procedures be performed in accordance with the AICPA's *Monitoring Guidance*. In its most recent inspection procedures, however, the firm did not review certain elements of quality control.

Recommendation—The firm should comply with its quality control policies and procedures by using all of the recommended forms in the AICPA's *Monitoring Guidance*. The use of these forms should result in the performance of all the required inspection procedures, including the review of all of the functional areas of quality control. In addition, a partner in the firm should be designated to monitor the firm's compliance with this policy.

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

Recommendation—The firm should perform its inspection procedures in a timely manner so that corrective actions can be implemented before engagements are performed in the subsequent year, and a partner of the firm should be designated to monitor the firm's timely performance of its annual inspection procedures.

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

Recommendation—The firm should comply with its quality control policies and procedures regarding inspection and a designated partner of the firm should monitor the firm's compliance with its policies and procedures and with professional standards.

- .94 Finding—The firm's policies and procedures require that the firm's postissuance review be sufficiently comprehensive to enable the firm to assess compliance with all applicable professional standards and the firm's quality control policies and procedures. During our review of several engagements, we noted ineffective postissuance review in

monitoring the firm's adherence to its quality control policies and procedures. This ineffective postissuance review resulted in the firm not complying with its policies and procedures for timely communication of engagement deficiencies to appropriate professional staff.

Recommendation—We recommend the firm hire an outside party to monitor the effectiveness of the firm's postissuance review, identify systemic reasons for engagement deficiencies, and communicate such deficiencies timely to appropriate professional staff.

- .95 Finding—The firm's monitoring policies and procedures require either inspection procedures or postissuance report and working paper review be performed periodically on a sample of the firm's accounting and auditing practice to ensure compliance with the elements of quality control. The monitoring policy further requires the inspection or postissuance review procedures be documented for each engagement and the findings summarized by each element of quality control. During our review, we were informed that neither inspection nor postissuance review procedures had been performed on a sample of the firm's accounting and auditing practice for the previous year.

Recommendation—We recommend the firm comply with its monitoring policies and procedures requiring periodic monitoring of its accounting and auditing practice. We further recommend the firm designate the partner in charge of the accounting and audit practice as the individual to determine the engagements to be selected for monitoring and to accumulate and distribute the results of the findings generated by the monitoring procedures to all professional staff.

#### SECPS Membership Requirements

- .96 Finding—The firm's policies and procedures require that each professional in the firm participate in at least 120 hours of continuing professional education every three years, with no less than 20 hours each year. The membership requirements also require professionals who spend more than 25 percent of their time performing accounting and auditing and attest services to have at least 40 percent of those continuing professional education hours in subjects related to accounting and auditing. Our review disclosed that, for the period ended June 30, 19XX, several of the firm's personnel failed to comply with both the three-year and the accounting and auditing continuing professional education requirements.

Recommendation—The firm should establish procedures to monitor compliance for all professionals, including those spending 25 percent or more of their time in accounting and auditing, with the Section's continuing professional education requirements.

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

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

- .98 Finding—The Section's membership requirements require a member firm to ensure that each member of the firm (proprietors, shareholders, or partners) that is eligible for AICPA membership be a member of the AICPA. Our review indicated that only one of the firm's partners is a member of the AICPA although other partners are eligible for membership.

Recommendation—The firm should take steps to ensure compliance with the Section's membership requirements.

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

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

- .100 Finding—The Section's membership requirements require that each member firm establish policies and procedures for concurring review of the report and financial statements by a partner other than the engagement partner in charge of an SEC engagement prior to the issuance of the audit report. The membership rules also require the in-charge person must be a partner in the firm. However, our review disclosed that although an appropriate concurring review had been performed, the person in charge of the firm's SEC engagement was not a partner.

Recommendation—The firm should modify its policies and procedures to require a partner of the firm be in charge of all SEC engagements.



.101 APPENDIX A - Sample Letter of Comments for the SECPS Peer Review Program

September 30, 19xx  
[Should correspond with date of report]

To the Partners  
Jones, Smith & Co.

We have reviewed the system of quality control for the accounting and auditing practice of Jones, Smith & Co. (the firm) in effect for the year ended June 30, 19xx, and have issued our report thereon dated September 30, 19xx (which was modified as described therein <sup>6</sup>). That report should be read in conjunction with the following comments, which were considered in determining our opinion.

**Matters That Resulted in a Modified Report <sup>7</sup>**

**Engagement Performance**

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

Recommendation-The firm should adopt procedures to ensure that clients' financial statements include all relevant disclosures. Such procedures would typically include concurring review by a partner with appropriate industry training and experience, and obtaining or developing comprehensive financial statement disclosure and reporting checklists.

---

<sup>6</sup> The phrase in parenthesis should be included if the review team issues a modified or adverse report. The wording should be tailored to fit the circumstances of the engagement.

<sup>7</sup> This caption is to be used only if a modified or adverse report is being issued and should be tailored to fit the circumstances.

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

Recommendations-The firm should (1) reemphasize the importance of its quality control policies and procedures for outside consultation, (2) more closely monitor compliance with its consultation policies and procedures during the preissuance review of engagements, (3) reemphasize its policy that professional staff consult regarding independence issues that arise during the performance of an engagement, and (4) emphasize these policies and procedures in its performance of inspection procedures.

#### **Matters That Did Not Result in a Modified Report**

##### **Acceptance and Continuance of Clients and Engagements**

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

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

##### **Independence, Integrity, and Objectivity**

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

Recommendation-We recommend that the firm amend its quality control policies and procedures to require documentation of the resolution

of independence, integrity, and objectivity questions.

#### **Engagement Performance**

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

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

Finding-The firm's quality control policies and procedures require the use of standard audit and work programs. However, in one recently acquired office of the firm, representing a small portion of the firm's practice, the firm's standard audit and work programs have not been used consistently.

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

#### **Membership**

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

Recommendation-The firm should develop procedures to monitor compliance with the minimum continuing professional education requirements for each of its professional staff members. Additionally, the firm should make sure that the five professionals referred to above obtain a sufficient number of continuing education hours to meet the Section's annual and three-year requirements for its current educational year.

2242            Standards for Performing and Reporting on Peer Reviews

.102    APPENDIX B - Checklist for Reviewing Drafts of Letters  
of Comments

	<u>Yes</u>	<u>No</u> <sup>8</sup>
1. Do the first two paragraphs of the letter of comments (LOC) conform with the standard LOC included in the applicable standards?	_____	_____
2. Is the letter of comments dated the same date as the report?	_____	_____
3. If the report is modified, have the comments been segregated appropriately in the section entitled "Matters That Resulted in a Modified (Adverse) Report"?	_____	_____
4. Are headings included for each quality control element on which there is a comment?	_____	_____
5. Is each finding and recommendation clearly captioned?	_____	_____
6. Are findings written with a systems orientation?	_____	_____
7. Are findings caused by the same quality control deficiency grouped into a single comment?	_____	_____
8. Are general terms used to indicate frequency of occurrence rather than specific numbers?	_____	_____
9. Have you avoided identifying, by name or otherwise, specific engagements, individuals, or offices?	_____	_____
10. Are comments written in a succinct, but complete, manner (without excessive details)?	_____	_____

---

<sup>8</sup> All no answers should be resolved before the letter of comments is finalized.

	<u>Yes</u>	<u>No</u> <sup>9</sup>
11. Are the findings clearly understandable to someone not familiar with the specific engagement and functional area findings?	_____	_____
12. Are findings written in a specific enough manner so that the comment will not automatically be repeated on the next review?	_____	_____
13. Have personal preference items been excluded from the letter?	_____	_____
14. Is the letter of comments free of all references to specific technical standards?	_____	_____
15. Have third-party practice aids been referred to in general terms?	_____	_____
16. Has the "loop been closed" in all cases in which significant performance deficiencies are mentioned without expressing negative assurance?	_____	_____
17. Are repeat comments clearly identified?	_____	_____

---

<sup>9</sup> See footnote 8.

.103 APPENDIX C - Examples of Poorly Written Letter of Comments Items

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

.104 Example 1:

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

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

**Critique of Example 1:**

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

**Suggested Rewording for Example 1:**

*Finding*—The firm's quality control policies and procedures require obtaining letters of inquiry from a client's attorney for all audit engagements. However, we noted instances where

the attorney's letters had not been obtained or were dated several weeks prior to the auditor's report. Subsequent to our review, the firm has requested and received the missing attorney letters and received updated responses for the attorney letters dated prior to the date of the auditor's report.

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

.105 **Example 2:**

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

**Critique of Example 2:**

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

**Suggested Rewording for Example 2:**

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

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

.106 **Example 3:**

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

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

**Critique of Example 3:**

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

**Suggested Rewording for Example 3:**

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

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



transactions.

.107 **Example 4:**

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

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

**Critique of Example 4:**

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

**Suggested Rewording for Example 4:**

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

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

.108 **Example 5:**

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

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

**Critique of Example 5:**

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

**Suggested Rewording for Example 5:**

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

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

**.109 Example 6:**

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

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

**Critique of Example 6:**

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

**Suggested Rewording for Example 6:**

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

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

.110 APPENDIX D - Guidance for Determining Whether a Finding Appeared in the Letter Issued in Connection With a Prior Peer Review

Paragraph .24(o) states—

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

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

.111 Example 1:

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

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

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

Prior Response—The firm has reemphasized its policies regarding the completion of a comprehensive disclosure checklist on all accounting and auditing engagements. These checklists will be completed by a member of the engagement

team, reviewed by the engagement partner, and retained with the engagement working papers.

### Results on Current Review

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

### Comparison of Prior and Current Deficiencies

In this example, the firm reinforced its policy on the use of a disclosure checklist in its letter of response. Therefore, the team captain must look for other weaknesses in the firm's system of quality control that could be causing the disclosure deficiencies to continue to occur.

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

#### .112 Example 2:

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

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

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

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

#### **Results on Current Review**

In the performance of the current year's review, the review team confirmed that the meeting of October 15, 19XX took place and that the firm's consultation policies were reviewed at that meeting. However, the review team also found that issues requiring consultation, such as a change in the method of recording inventory and a pooling of interests, were not reported appropriately.

#### **Comparison of Prior and Current Deficiencies**

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

.113 **APPENDIX E - Case Studies on Writing Letter of Comments**

Reviewers are often asked to revise letters of comments because they describe engagement deficiencies without identifying the deficiencies in the firm's system of quality control that caused them. If the reviewer does not understand the underlying cause, he or she cannot make recommendations to the firm that will reduce the likelihood of the deficiencies recurring.

Because the same engagement deficiencies may come from completely different causes, reviewers should make sure findings and recommendations are based on careful thought and discussions with the partners of the firm about their underlying cause(s). To determine the underlying cause(s) of engagement deficiencies, a reviewer sometimes needs to expand testing in an area. This expanded testing will also allow the reviewer to determine whether a deficiency is isolated or pervasive.

In evaluating engagement deficiencies, the review team should consider all aspects of a firm's system of quality control and try to determine the cause(s) of those deficiencies. In some cases the cause(s) of certain deficiencies from a quality control perspective may not be clear and may appear to be the result of a combination of factors. When the most likely cause(s) of the deficiencies cannot be readily identified, the review team should hold further discussions with the partners of the reviewed firm. Together, the reviewed firm and the review team will be able to identify the cause(s) of the deficiencies and develop a plan for reducing the likelihood of their recurrence.

The following case studies are designed to provide review teams with illustrations of the process of searching for the underlying cause(s) of engagement deficiencies.

.114 **Case Study One**

*Facts About the Reviewed Firm:* ABC, P.C. is a CPA firm with two partners, one manager, and four other professional staff. The manager has six years of experience and the other four professionals have from six months to two years of experience.

*Last Peer Review Findings:* On the firm's last peer review, it received an unmodified report with a letter of comments citing a failure to comply with the firm's policies and procedures for documenting analytical review procedures and the engagement team's assessment of risk and materiality

considerations. The firm's responses to the recommendations of the review team appeared to address the deficiencies adequately and seemed comprehensive and feasible in the circumstances.

*Current Peer Review Engagement Observations:* The firm performed only one audit engagement subject to government auditing standards, a not-for-profit organization receiving federal awards and subject to the audit requirements set forth in OMB Circular A-133. As required, this engagement was included in the scope of the peer review and the review team noted the following engagement deficiencies—

- a. A third-party developed audit program for governmental engagements was included in the working papers, but it was not properly initialed or dated by engagement personnel at the completion of the procedures.
- b. The firm did not issue a report on compliance with general requirements as required by Office of Management and Budget (OMB) Circular A-133.
- c. During the audit, the firm noted the client had made a nonqualifying expenditure and had failed to establish a drug-free workplace policy. These are areas of noncompliance with general requirements.
- d. The firm issued a report on irregularities and illegal acts even though no such events were discovered during the performance of the audit.

During the discussions of the above matters with the manager on the engagement, the review team learned the following—

- a. The firm borrowed a governmental audit program from another CPA firm in the same building, since this was the only engagement the reviewed firm performed pursuant to *Government Auditing Standards*.
- b. The nonqualifying expenditure was a political contribution for \$25 to a candidate running for a local office. Because one partner of the CPA firm served as treasurer of the candidate's political campaign, the manager decided the contribution did not need to be mentioned in a report.

*Current Peer Review Finding:* While the manager agreed the proper reports had not been issued and indicated the engagement partner had pressured him into completing the



engagement before the partner left on vacation, the review team explored further the underlying causes of the engagement deficiencies with the firm's partners. During this exploration, it learned—

- a. The engagement partner had no prior government auditing experience.
- b. Because this was the only engagement performed by the firm under *Government Auditing Standards* and because the engagement partner was trying to keep the engagement costs to a minimum, only the manager on the engagement had taken any governmental accounting or auditing related continuing professional education, and that training only consisted of a four-hour self-study update on *Government Auditing Standards*.
- c. Even though the firm's consultation policies require that an adequate up-to-date library be maintained, the firm's library did not contain a copy of the *Government Auditing Standards*, the Single Audit Act, OMB Circular A-133, or a third-party auditing or accounting manual for the performance of engagements pursuant to governmental auditing standards.
- d. The firm accepted the audit engagement because one of the partners did not want to lose a business opportunity to a competitor and had indicated at a local chamber of commerce function that the firm performed audits of not-for-profit organizations receiving federal awards.

*Possible Letter of Comments Items Resulting From This Case:* Depending on the conclusions reached as to the underlying cause of the deficiencies, the related finding and recommendation included in the letter of comments might be one of the following,

#### **Engagement Performance**

Finding—The firm's policies and procedures for consultation require an adequate reference library be maintained as a resource for performing engagements in specialized areas and for solving problems identified on engagements. During our review, we noted that the firm did not have copies of various government auditing standards even though it had a client, the audit of which is subject to those standards. As a result, an inappropriate report was issued on irregularities and illegal acts and a report on compliance with general

requirements was not issued. The firm has agreed to recall the inappropriate report on irregularities and illegal acts and issue the report on compliance with general requirements.

Recommendation—The firm should designate an individual within the firm to ensure that its library, or access to such a library, provides adequate resources for performing engagements in all areas in which the clients of the firm practice and for solving accounting and auditing problems identified on engagements.

#### **Personnel Management**

Finding—The firm's policies require all professional staff to comply with applicable state board of accountancy and AICPA continuing professional education requirements. While the professional staff was in compliance with this policy, sufficient courses were not taken in government accounting and auditing to comply with the *Government Auditing Standards*, a new practice area for the firm. As a result, an inappropriate report was issued on irregularities and illegal acts and a report on compliance with general requirements was not issued. The firm has agreed to recall the inappropriate report on irregularities and illegal acts and issue the report on compliance with general requirements.

Recommendation—The firm's policies and procedures for professional development should be revised to ensure that firm personnel participate in training courses in all areas in which the firm practices and to monitor compliance with the professional education requirements outlined in the *Government Auditing Standards*.

#### **Acceptance and Continuance of Clients and Engagements**

Finding—The firm's quality control policies and procedures require evaluation of prospective clients for approval prior to acceptance. During our review, we noted the firm accepted an engagement subject to *Government Auditing Standards* when it had no experience in that area and its library did not include materials related to such engagements. As a result, an inappropriate report was issued on irregularities and illegal acts and a report on compliance with general requirements was not issued. The firm has agreed to recall the inappropriate report on irregularities and illegal acts and issue the report on compliance with general requirements.

Recommendation—The firm should follow its quality control policies for client acceptance and not accept engagements in specialized industries unless it obtains the expertise

necessary to perform those engagements in accordance with professional standards. This matter should be addressed in the firm's monitoring procedures of its quality control policies.

.115 **Case Study Two**

*Facts About the Reviewed Firm:* XYZ & Associates is a CPA firm with three partners and four professional staff. Two of the partners perform primarily tax work, but they also perform engagements involving compilation reports on complete sets of financial statements ("full disclosure compilations") and compilation reports on financial statements that omit substantially all disclosures required by generally accepted accounting principles or an other comprehensive basis of accounting ("compilations that omit disclosures"). The third partner, who also prepares tax returns and performs compilation engagements, is responsible for all of the firm's audit and review engagements. Each partner is responsible for reviewing his or her own work.

The firm uses practice aids developed by a third-party provider and has identified in its quality control policies and procedures those forms and checklists that are required and those that are optional. The firm's accounting and auditing practice consist of 15 audits and reviews for 2,100 hours and 65 compilations for 1,100 hours.

*Last Peer Review Findings:* On the firm's last review, it received an unmodified report with a letter of comments citing the firm's failure to carefully complete reporting and disclosure checklists and the incomplete or omitted disclosures noted on the engagements reviewed. (The specific omissions were not identified.)

*Current Peer Review Engagement Observations:* The review team noted the following deficiencies on the engagements reviewed:

- a. On the two full disclosure compilation engagements selected for review, various disclosures were consistently omitted, including terms of operating leases, concentrations of credit risk relating to bank balances and trade accounts receivable, interest and income taxes paid when the indirect method was used for the cash flow statement, and noncash financing and investing activities for the cash flow statement.
- b. On the audit and review engagements selected for review, only a few isolated and minor disclosures were missed.

Even though the omitted disclosures on the compilation engagements did not make any of the financial statements misleading, the review team believed the omissions reflected a weakness in the firm's system of quality control for which the underlying cause needed to be identified. Since the review team believed further information was needed to identify the underlying cause, the team selected three additional full disclosure compilations — one for each partner. The review team found similar missing disclosures on the compilations performed by the two partners primarily responsible for the tax practice (who were also the partners on the two compilations initially reviewed) and no disclosure deficiencies on the compilation engagement performed by the partner responsible for the audit practice.

*Current Peer Review Findings:* Based on a comparison of the original engagements selected for review and the additional engagements reviewed, the review team determined that the firm had complied with its policies and procedures requiring the completion of financial statement reporting and disclosure checklists on all engagements involving a report on a full set of financial statements. While a review of the completed reporting and disclosure checklists indicated each of the omitted disclosures was on the checklist (though some were referred to only briefly), the partners' responses were inappropriately marked "N/A" or "yes."

Based on the expanded scope and discussions with the partners, the review team was able to determine that the two partners primarily responsible for the tax practice were not reviewing the disclosure checklists carefully. The two partners also admitted they were not familiar with the disclosure requirements omitted and had not reviewed the disclosure checklists carefully because such review was time-consuming. Even though all CPAs in the firm had met their state board of accountancy continuing professional education requirements, the review team noticed that these two partners had taken no training courses on accounting and auditing topics during the last three years.

*Possible Letter of Comments Item Resulting From This Case:* The review team determined the finding was not a repeat from the firm's last review because the underlying cause of the engagement deficiencies was different and, after discussing possible solutions with the firm's partners to correct the weakness identified, decided the following engagement performance finding for supervision and recommendation should be included in the letter of comments:

**Engagement Performance**

*Finding*—The firm's quality control policies and procedures require all accounting and auditing engagements to be properly supervised and reviewed. Our review noted that certain compilation engagements involving a complete set of financial statements were reviewed by members of the firm whose primary practice areas are not financial statement engagements and those individuals did not participate in sufficient accounting courses during the period. The financial statements for these engagements did not include all of the disclosures required by professional standards, particularly in concentrations of credit risk and cash flow statements. None of the missing disclosures were of such significance as to make the financial statements misleading.

*Recommendation*—The firm should revise its policies and procedures to require a preissuance review of full disclosure compiled financial statements by a qualified individual. In addition, all firm members responsible for reviewing financial statement engagements should periodically take appropriate courses on accounting and auditing topics.

*Possible Letter of Comments Item Resulting From This Case:* If the review team had determined that the partners had participated in a reasonable number of training courses on accounting and auditing topics and observed during its review that the disclosure checklists on compilation engagements were haphazardly completed, the review team would probably have concluded the matter was a repeat finding from the last review and the following engagement performance finding and recommendation would have been included in the letter of comments:

**Engagement Performance**

*Finding*—The firm's quality control policies and procedures require accounting and auditing engagements to be properly supervised and reviewed. During our review, we noted on several full disclosure compilation engagements that, although a partner reviewed the firm's report and the accompanying financial statements, the disclosure checklist required by firm policy on such engagements was inappropriately completed. As a result, the financial statements of those engagements did not include all of the disclosures required by professional standards, particularly in concentrations of credit risk and cash flow statements. None of the missing disclosures were of such significance as to make the financial statements misleading. A similar finding was reported in the firm's last peer review.

Recommendation—The firm should revise its policies and procedures to require a preissuance review of full disclosure compiled financial statements by a designated and qualified individual. In addition, guidance should be provided to firm members reminding them to diligently complete all disclosure checklists.

.116 **Case Study Three**

*Facts About the Reviewed Firm:* LMNOP, S.C., is a CPA firm with three partners and three other professional staff with experience ranging from one to five years. Two of the three partners are responsible for one audit each, while all the partners are responsible for compilation and review services. All partners and staff are significantly involved in tax preparation and related services, which is a sizable portion of the firm's practice.

*Last Peer Review Findings:* This is the firm's initial peer review.

*Current Peer Review Engagement Observations:* While performing the review, the review team noted lack of documentation for the following areas of planning on the audit engagement selected for review:

- a. Consideration of matters affecting the industry
- b. Preliminary judgment of materiality
- c. Analytical review procedures
- d. Internal control structure
- e. Assessment of risk

Although the planning area of the audit program was initialed and dated, few working papers existed to support the audit program steps. In addition, documentation of a certain other areas of the audit was also deficient and little documentation existed for the partner's review of the working papers.

After discussing the above findings with the partner and staff on the engagement and reviewing the firm's written responses to the matter for further consideration forms detailing the procedures performed by the firm, the review team determined that, although the firm had performed inadequate testing of the system of internal control, sufficient planning procedures had been performed in all other areas though they were not documented. The review team was also able to conclude that similar deficiencies would be encountered on the other audit performed by the firm.

*Current Peer Review Finding:* The review team believes the firm's quality control policies and procedures are adequately designed for a firm of its size and that the library is appropriate since it contains, among other things, appropriate auditing and accounting practice aids purchased from a third-party provider. When asked by the review team about the reason for the lack of documentation and the inadequate testing of internal control, the partner indicated that they had encountered time constraints when completing the audit.

*Possible Letter of Comments Items Resulting From This Case:* The review team concluded an engagement performance comment such as the following should be included in the letter of comments because the partner's review of the engagement was not adequate to identify the documentation and performance deficiencies:

#### **Engagement Performance**

*Finding*—The firm's policies and procedures require a partner to review audit working papers, financial statements, and auditors' reports. However, the firm's planning working papers do not include documentation of the firm's preliminary judgment about materiality, assessment of risk, analytical review procedures, and conditions requiring extensions or modification of tests. Through discussion with firm personnel, we were able to satisfy ourselves that appropriate planning procedures in the above areas had been performed. However, there was inadequate testing of the internal control structure in an instance where such testing was required. The firm has subsequently performed the omitted procedures to support the opinion issued on the engagement.

*Recommendation*—The partner responsible for the engagement should review and approve the engagement planning procedures. In addition, the partner should perform a more diligent review of the working papers, financial statements, and auditors' report, and should document that review in the working papers.

*Possible Letter of Comments Items Resulting From This Case:* The nature of this letter of comments finding and recommendation would differ entirely if —

- a. The review team had learned during further discussions with the professional staff on the audit engagements that the staff was uncertain about how to perform the procedures outlined in the planning area of the audit program and the working papers necessary to support the

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

work performed,

- b. The firm had provided its partners and professional staff with a substantial number of training courses in the tax area during the last three years, but few courses in the accounting area and none in the audit area, and the partners had indicated that training courses in the audit area were not beneficial to the firm because the firm only performs the two audits to fill in during its slower periods.

If these conditions had been encountered, the review team might have determined that a more thorough review of the working papers by the partners would not necessarily have found the performance deficiencies or the need for additional planning documentation. As a result, the review team might have decided the letter of comments should contain a finding for a design deficiency in the firm's system of quality control related to personnel management as follows:

**Personnel Management**

Finding—The firm's quality control policies require all professional staff to participate in forty hours of continuing professional education each year. Even though the firm's personnel met these requirements, the courses taken did not provide the firm's personnel with sufficient information about auditing pronouncements and related procedures. As a result of inadequate training, on the audit engagement reviewed, the firm's planning working papers did not include documentation of the firm's preliminary judgments about materiality, assessment of risk, analytical review procedures, and conditions requiring extensions or modification of tests. In addition, inadequate testing of the internal control structure was performed in an instance where such testing was required. The firm has subsequently performed the omitted procedures to support the opinion issued on that engagement.

Recommendation—The firm should revise its quality control policies to require firm personnel to participate in an appropriate amount of professional development courses relating to all the areas in which they perform services. In addition, the firm should assign an individual the responsibility of monitoring the professional development courses taken during the year to ensure that appropriate courses have been taken in all of the areas in which the firm practices.



.117 Case Study Four

*Facts About the Reviewed Firm:* AEIO & U is a CPA firm with four partners and ten other professional staff. The firm's practice is predominantly accounting and auditing. While most professional staff perform some tax services, one partner of the firm performs only tax services and supervises two seniors and one manager who perform only tax work.

*Last Peer Review Findings:* Each of the firm's last two reviews resulted in the issuance of an unmodified report without a letter of comments.

*Current Peer Review Engagement Observations:* While performing the review, the review team noted several engagements where the financial statements reported on by the firm did not include all of the disclosures required by generally accepted accounting principles. However, the deficiencies noted did not make the financial statements misleading. On each engagement on which disclosure deficiencies were noted, the firm's required reporting and disclosure checklist was inappropriately completed. Disclosure deficiencies were noted on engagements supervised by all of the firm's partners.

*Current Findings:* The review team believes the firm's quality control policies and procedures were suitably designed and appropriately modified throughout the years for changes in the firm's practice. The firm has adopted practice aids developed by a third-party provider for use on engagements and provided appropriate training to its accounting and auditing personnel on the use of the materials.

The firm belongs to an association of CPA firms and its annual inspection procedures were performed by qualified members of that association. However, inspection procedures were not performed during the year of the peer review.

Although it appears on the surface that the firm has not complied with its engagement performance policies and procedures, investigation of the underlying cause of the deficiencies by the review team revealed that—

- a. The background information provided by the firm during the planning stage of the review stated the firm's accounting and auditing hours grew by 15 percent while its total number of professional staff remained constant.

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

- b. The firm's recent growth occurred predominantly in the not-for-profit area, a firm specialty, according to interviews with partners of the firm involved in accounting and auditing. Rather than hire additional personnel during the firm's busy season, the firm assigned the two tax seniors to supervise the work on a few audit and review engagements. The firm also assigned one audit senior the responsibility for supervising the fieldwork on two audits of large not-for-profit entities even though that individual had minimal experience auditing such entities.

When the scope of the review was expanded to review two additional engagements prepared by the staff discussed above, similar deficiencies were found.

*Possible Letter of Comments Item Resulting From This Case:* The review team concluded that the deficiencies noted during the review were the result of the assignment of inexperienced personnel to engagements and that the following finding and recommendation should be included in the letter of comments:

**Personnel Management**

Finding—The firm's quality control policies and procedures require that the partners evaluate planning schedules to ensure that the personnel assigned to an engagement have sufficient experience or expertise to perform the work assigned to them. However, on some engagements reviewed, the personnel below the partner level did not appear to have adequate experience or expertise to handle their assigned tasks. As a result, we noted several instances where the financial statements reported on by the firm did not include all of the disclosures required by generally accepted accounting principles. However, none of the missing disclosures were of such significance to make the financial statements misleading.

Recommendation—The firm should carefully consider the degree of technical training and proficiency required in the circumstances prior to making personnel assignments. When it is necessary to assign a key role on an engagement to a person who does not have sufficient experience or expertise to handle all the work assigned, the partner in charge of the engagement should document how the engagement team will compensate for this deviation from firm policy.

.118 Case Study Five

(This is a case study pertaining to a large firm. It includes helpful guidance on dealing with merged and acquired practices regardless of the size firm.)

*Facts About the Reviewed Firm:* B & B is a four-office CPA firm with the following characteristics:

	Office A	Office B	Office C	Office D	Firm Total
Partners	4	3	2	3	12
Other professionals	16	14	7	11	48
A&A hours	15,000	13,000	7,000	8,000	43,000
SEC clients	1	0	0	0	1
Yellow Book	3	2	1	2	8

The firm's main office, office A, was founded in 1972. Offices B, C, and D were acquired through mergers in 1984, 1989, and 1993, respectively. The most recent merger was effective July 1, 1993, the start of the firm's current peer review year. There were extensive financial negotiations prior to each merger and both sides performed limited due diligence procedures with respect to the quality of the other firm's accounting and auditing and tax practices. During the peer review year ended June 30, 1994, approximately 45 percent of the firm's charged hours were in accounting and auditing, approximately 45 percent in tax, and the remainder in consulting. The firm's only SEC client is a mature, low-risk company requiring about 400 hours to audit.

*Last Peer Review Findings:* On the firm's last peer review, it received an unmodified report with a letter of comments citing failure to comply with the firm's policies and procedures for documenting oral communications to audit committees as required under Statement on Auditing Standards No. SAS 61, *Communication With Audit Committees*, (AICPA, Professional Standards, vol 1, sec AU 380).

*Current Peer Review Engagement Observations:* The peer review covered all the partners in offices A and D. The review of office A included five audits, one subject to *Government Auditing Standards* and the firm's sole SEC client, two reviews, and one compilation. The peer review results in office A were excellent; the review team found only a few isolated and unrelated minor documentation deficiencies.

The review of office D included six audits (two for each

partner), two reviews, and one compilation. On two audits the review team concluded the engagements did not comply with generally accepted auditing standards in all material respects, and on one review engagement, the review team concluded the engagement did not comply with the performance standards of the *Statements on Standards for Accounting and Review Services* in all material respects. In addition, the work on all of the other engagements reviewed had deficiencies.

The three engagements that did not conform with professional standards in all material respects resulted from the following:

- a. On an audit of a manufacturing company only negative confirmation requests were circulated even though none of the three conditions for sending negative confirmations set forth in Statement on Auditing Standards No. 67, *The Confirmation Process*, paragraph 20, (AICPA *Professional Standards*, vol. 1, AU sec. 330) were met.
- b. No legal letter was sent on one audit even though outside counsel had been consulted during the year in connection with potential litigation. Management stated in its management representation letter that the company was not a plaintiff or a defendant in any litigation matters, and that it was not aware of any unasserted claims or assessments.
- c. A management representation letter was not obtained on one review engagement.

The review team expanded its scope to look at the legal letters and confirmation procedures on five additional audits in office D. In each case, positive confirmations were used appropriately and legal letters were obtained, except on one audit where the client did not have any legal counsel and management represented in writing that the company was not involved in any litigation and was not aware of any unasserted claims or assessments. The review team also looked at the client representation letters on three additional review engagements, and noted that an appropriate letter was obtained in each case.

The firm immediately performed, under the direction of the director of accounting and auditing in office A, the necessary additional procedures on the three engagements and concluded that the financial statements and the firm's report were appropriate in each case. The review team reviewed the

additional work and agreed with the firm's conclusions in each case.

*Current Findings:* The results of the firm's inspection procedures performed during each of the two years between peer reviews were excellent and covered the work of all partners. The firm does not perform inspection procedures in a peer review year.

After extensive discussions with firm management in an attempt to discover the reasons for the poor quality work in office D, the review team learned—

- a. The firm does not have any formal written policies for assessing the quality of the accounting and auditing practices of a potential merger or acquisition candidate prior to a merger or acquisition.
- b. The merger negotiations focused almost exclusively on financial matters, and the firm performed limited due diligence procedures with respect to the quality of the work of the firm that became office D.
- c. The only training office D personnel received regarding the firm's policies and procedures was a two-hour session four days after the effective date of the merger, and that session primarily covered administrative matters.
- d. There was no interchange of personnel on engagements between offices A, B, and C on the one hand and office D on the other.
- e. No one from the three previously existing offices of the firm performed any preissuance reviews of the working papers, financial statements, or reports issued by office D from the time of the merger until the commencement of the peer review.

*Possible Letter of Comments Item Resulting From This Case:* Three of the nine engagements reviewed from the recently merged-in office D were not in conformity with professional standards and additional procedures had to be performed on them. The engagement deficiencies resulted from the lack of adequate policies for the evaluation of potential merger candidates and the failure to adequately train staff from the merged practice. If the review team concludes that an unmodified peer review report can be issued, the letter of comments might include the following finding and recommendation in engagement performance:

**Engagement Performance**

Finding—The firm has very limited quality control policies and procedures for assessing the quality of the accounting and auditing practice of a potential merger or acquisition candidate and for providing reasonable assurance that personnel from a merged or acquired practice will comply with professional and firm standards. The firm merged with a smaller firm at the beginning of the peer review year. The peer review noted several instances where engagements in the merged office did not comply with generally accepted auditing standards or the *Statements on Standards for Accounting and Review Services*. In each case, the omitted procedures were performed promptly, and the client's financial statements and the firm's report were deemed to be appropriate.

Recommendation—We recommend that the firm establish written quality control policies and procedures to provide reasonable assurance that personnel from accounting and auditing practices acquired by merger or acquisition will comply with professional and firm standards. Such policies and procedures should include—

- a. Performing appropriate due diligence procedures, including reviewing a sample of the potential merger or acquisition candidate's accounting and auditing engagements prior to the merger or acquisition.
- b. Providing training programs for the personnel from merged or acquired practices that cover the firm's policies and procedures for accounting and auditing engagements, and where necessary, professional standards.
- c. Assigning personnel from existing offices to accounting and auditing engagements performed by personnel from the merged or acquired practice, and vice versa.
- d. Requiring the firm's director of accounting and auditing or designee to perform detailed preissuance reviews of the working papers, financial statements, and reports for some or all of the merged office's accounting and auditing engagements.

**.119 Case Study Six**

*Facts About the Reviewed Firm:* A and B is a CPA firm with four partners and sixteen professional staff.

*Last Peer Review Findings:* The firm's last peer review was unmodified without a letter of comments.

*Current Peer Review Engagement Observations:* During the review, the review team noted the reviewed firm issued a review report which included a final paragraph stating a lack of independence. The engagement file included a Review Engagement Work Program that contained a step related to independence and cautioned that a review report could not be issued if the firm was not independent.

*Current Findings:* After further investigation the review team learned that—

- a. The partner responsible for the engagement signed off as reviewing the engagement, but performed only a cursory review of the staff's work.
- b. The staff member on the engagement had been with the firm three years, but worked almost exclusively in the tax area.
- c. The staff member had taken only ten hours of continuing education in accounting and auditing subjects during the past three years.
- d. The other work supervised by this partner contained no major deficiencies. However, the quality of the partner's work was not up to the same standard as that of the other partners in the firm.

Because the specific underlying cause of the deficiency had not been determined, the review team held extensive discussions with the firm's partners and, as a result, concluded—

- a. The firm had adequate policies and procedures for independence, integrity, and objectivity. The firm communicated its policies and procedures to the staff, independence confirmations were obtained and all questions resolved. All other engagements where the firm noted a lack of independence were compilation engagements.
- b. The firm had adequate policies and procedures for assigning personnel to engagements. The firm attempts to use tax staff on low-risk audit and accounting engagements to aid in their overall development and assigns an audit partner or audit manager to supervise their work.

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

- c. The firm had adequate policies and procedures for personnel management for professional development. All staff were in compliance with the professional development requirement. However, the tax staff generally had less than sixteen hours of professional education in accounting and auditing over the three-year period.
- d. The failure on the review engagement was due to a lack of supervision by the partner even though the firm had adequate engagement performance policies and procedures for supervision.

*Possible Letter of Comments Item Resulting From This Case:*  
The review team and firm agreed that the following finding and recommendation were appropriate:

**Engagement Performance**

Finding—The firm's quality control policies and procedures require preparation and completion of work programs that appropriately request the preparer to affirm the firm's independence. However, the firm issued a review report stating a lack of independence, which is not in accordance with professional standards. The work program was inappropriately signed off, and the review process failed to note this error. The firm has recalled the review report and issued a compilation report.

Recommendation—The firm has adequate policies and procedures for engagement performance. However, a more thorough review of the work program by the staff and the partner would have prevented the violation of professional standards. We recommend that the firm hold in-house training sessions to review the work programs and checklists currently utilized. The training sessions should be attended by all personnel involved in the accounting and auditing process.

[END]



**SECPS Section 2300****SUGGESTIONS FOR WRITING A RESPONSE TO A LETTER OF COMMENTS****TABLE OF CONTENTS**

<b><u>Section</u></b>		<b><u>Paragraph</u></b>
2300	Suggestions for Writing a Response to a Letter of Comments	
	Peer Review Standards . . . . .	.01-.02
	Contents of the Response . . . . .	.03-.05
	Committee Consideration of Peer Review Documents . . . . .	.06-.09
	Appendix - Sample Letter of Response. . .	.10

Suggestions for Writing a Response to a Letter of Comments<sup>1</sup>

PEER REVIEW STANDARDS

- .01 Upon completion of the peer review, the review team will communicate its findings to a reviewed firm at an exit conference. The team captain ordinarily will issue a report and a letter of comments, if any, within thirty days of the firmwide exit conference. Within fifteen days of the issuance of these documents, the reviewed firm is required to submit to the SECPS Peer Review Committee (the Committee) a copy of the report, the letter of comments, and a written response to the matters contained in that letter.
- .02 The reviewed firm should submit a draft of the letter of response to the team captain for review and comment before submitting the letter of response to the Committee. At the time the peer review documents are submitted to the Committee, the reviewed firm should also confirm in writing that (a) a draft of the letter of response was sent to the team captain, (b) the draft was discussed with the team captain, and (c) appropriate actions were taken on the comments, if any, received from the team captain in the draft. A suggested transmittal letter for communicating this information is included as appendix B of the "Instructions to Firms" in the *SEC Practice Section Peer Review Program Manual*.

CONTENTS OF THE RESPONSE

- .03 The response should be addressed to the Committee and should describe the actions taken or planned with respect to each matter in the letter. Depending on the circumstances, the firm might in responding to the letter of comments-
  - a. Agree entirely with a finding and the need to implement the recommended action.
  - b. Agree entirely with a finding, but believe that an alternative action is more appropriate than the one recommended.
  - c. Agree entirely with a finding, but disagree with the need to implement any corrective action.

---

<sup>1</sup> This section summarizes the descriptions pertaining to letters of response and the peer review committee's consideration of peer review reports discussed in SECPS §2000.118-.128.

- d. Disagree with a finding in some respect, but agree with the need to implement the recommended action.
  - e. Disagree with a finding in some respect, but believe an alternative action is more appropriate than the one recommended.
  - f. Disagree entirely with a finding and the recommended action.
- .04 If the firm disagrees with either a finding or the recommended corrective action, its letter of response should describe the basis and rationale for the disagreement.
- .05 Appendix A, SECPS §2300.10, illustrates how a firm might respond to a letter of comments.

#### COMMITTEE CONSIDERATION OF PEER REVIEW DOCUMENTS

- .06 A report on a peer review is sent to the Committee together with the letter of comments, if any, and the reviewed firm's response to the letter. Upon acceptance of the final peer review documents by the Committee, the firm will be notified in writing of the acceptance and the documents will be placed in the public files of the Division for CPA Firms.
- .07 Before acceptance, the staff of the AICPA SEC Practice Section Team (the staff) will review the aforementioned peer review documents and all or some of the review team's working papers. The staff will evaluate whether the findings appear to be properly reported upon and report its conclusions to the Committee. The Committee also will review the peer review documents and consider the comments of its staff, and if applicable, of the Public Oversight Board or its staff. During its review, the Committee will decide whether-
- a. The peer review has been performed and reported upon in accordance with the peer review standards promulgated by the SECPS Peer Review Committee.
  - b. The reviewed firm or the Committee needs to take any additional actions.
- .08 Several factors influence the Committee's decisions on item b in paragraph .07. The factors include the Committee's judgment regarding-
- a. The nature and significance of the matters in the letter of comments.

- b. Whether the reviewed firm's response presents either a satisfactory course of action or convinces the Committee that additional action is unnecessary.
  - c. Whether the reviewed firm's response to a matter appears to be an arbitrary rejection of the comment or an inappropriate conclusion not to take suitable action.
- .09 The Committee will then decide whether to accept a report, letter of comments, and letter of response. In some cases, a review team captain may be asked to revise the report or letter of comments or a firm may be asked to revise its response in whole or in part or to agree to take certain additional actions. When additional actions are required, they may include-
- a. Obtaining documentary evidence the matter has been appropriately treated by the reviewed firm.
  - b. Requesting the reviewed firm, at the firm's expense, to have a revisit by the team captain or other party during the performance of its monitoring procedures.
  - c. Requesting the reviewed firm, at the firm's expense, to engage a reviewer to revisit the firm to evaluate whether appropriate action has been taken.
  - d. Requesting the reviewed firm, at the firm's expense, to engage the team captain or other party to review the documentation supporting the action(s) taken on an engagement reviewed during the peer review for which the reviewed firm concluded that it had failed to reach an appropriate conclusion on the application of professional standards.
  - e. Requesting firm personnel to obtain additional appropriate continuing professional education.
  - f. Requesting the reviewed firm, at the firm's expense, to hire a competent party from outside the firm to perform a preissuance review of reports, accompanying financial statements, and related working papers, and to perform such other functions as the Committee or the firm deems appropriate.
  - g. Requesting the reviewed firm to agree to accelerate the date of its next peer review.
  - h. Recommending to the SECPS Executive Committee that sanctions be imposed on the reviewed firm.

.10 APPENDIX - Sample Letter of Response

Jones, Smith & Co.  
Certified Public Accountants  
New York, NY

October 15, 19\_\_

SECPS Peer Review Committee  
c/o American Institute of Certified Public Accountants  
SEC Practice Section  
Harborside Financial Center  
201 Plaza Three  
Jersey City, NJ 07311-3881

Ladies and Gentlemen:

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

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

**Engagement Performance**

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

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

<sup>1</sup> This caption is to be used only if a modified (including adverse) report has been issued and should be tailored to fit the circumstances.

inquire, before the report is issued, about compliance with our engagement performance policies for consultation. Furthermore, compliance with the firm's consultation policies and procedures will be emphasized during the performance of our inspection procedures.

### **Matters That Did Not Result in a Modified Report**

#### **Acceptance and Continuance of Clients and Engagements**

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

#### **Independence, Integrity, and Objectivity**

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

#### **Engagement Performance**

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

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

#### **Membership**

The five professionals referred to in the letter of comments all registered for a sufficient number of continuing professional education courses to meet the current annual and three-year

2308

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

requirements. In addition, an individual has been assigned the responsibility of maintaining continuing professional education records for all professionals and preparing quarterly CPE reports for the quality control partner.

Sincerely,

Jones, Smith & Co.

[END]

## SECPS Section 2400

STANDARDS FOR PERFORMING AND REPORTING ON REVIEWS OF QUALITY  
CONTROL MATERIALS

## TABLE OF CONTENTS

<u>Section</u>	<u>Paragraph</u>
2400 Standards for Performing and Reporting on Reviews of Quality Control Materials	
Introduction . . . . .	.01-.03
Objectives of a Review of Quality Control Materials . . . . .	.04
Applicability . . . . .	.05-.08
Standards for Performing QCM Reviews . . . . .	.09-.13
Qualifications for Serving as QCM Reviewers . . . . .	.09-.10
Procedures for Performing QCM Reviews . . . . .	.11-.13
Standards for Reporting on QCM Reviews . . . . .	.14-.24
The Review Team's Report . . . . .	.14
Unmodified Report . . . . .	.15-.16
Modified Report . . . . .	.17-.18
Letter of Comments . . . . .	.19-.23
Letter of Response . . . . .	.24
 Appendixes	
A—Sample Unmodified Report . . . . .	.25
B—Sample Letter of Comments . . . . .	.26
C—Elements of a Provider's System for the Development and Maintenance of Quality Control Materials . . . . .	.27
D—Guidance for Firms Using Acquired Quality Control Materials . . . . .	.28



INTRODUCTION

- .01 Quality control materials (QCM) are materials that are suitable for adoption by a firm as an integral part of that firm's system of quality control.<sup>1</sup> Such materials provide guidance in conforming with professional standards and may include, but are not limited to, such items as:
- a. Engagement aids, including accounting and auditing manuals, checklists, questionnaires, work programs, computer-aided accounting and auditing tools, and similar materials intended for use by accounting and auditing engagement teams
  - b. Personnel manuals, inspection checklists, hiring forms, and client acceptance and continuance forms
- .02 Occasionally, organizations (hereinafter referred to as "providers") may sell or otherwise distribute to CPA firms quality control materials that they have developed (hereinafter referred to as "user firms").
- .03 Providers may elect voluntarily or be required (see SECPS §2400.05, Applicability) to have an independent review of their system of quality control for the development and maintenance of the quality control materials they have developed and of the materials themselves.<sup>2</sup> The reasons for having such a review are-
- a. To provide assurance to user firms that the quality control materials they have acquired are reliable aids to assist them in conforming with the professional standards the materials purport to encompass.

---

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

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

## 2404 Standards for Performing and Reporting on Peer Reviews

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

### OBJECTIVES OF A REVIEW OF QUALITY CONTROL MATERIALS

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

### APPLICABILITY

- .05 An independent review of the system for the development and maintenance of quality control materials and the resultant materials (the "QCM review") is required for the following classes of providers:
  - a. A member firm providing quality control materials to another member firm for which the provider firm will perform the peer review
  - b. An association of CPA firms providing quality control materials that meet the definition of association quality control materials to its member firms when the peer reviews of those firms are to be administered by the association<sup>3</sup>
- .06 A provider of quality control materials falling into either of these categories should have a QCM review once every three years. In the event of substantial change in the system for the development and maintenance of the materials or in the resultant materials, the provider should consult with the SEC

---

<sup>3</sup> See Appendix A - "Interpretation: Association Quality Control Materials", SECPS §3000.09.

Practice Section Peer Review Committee ("the Committee") to determine whether an accelerated review is warranted.

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

**STANDARDS FOR PERFORMING OCM REVIEWS**

**Qualifications for Serving as OCM Reviewers**

- .09 A QCM review may be performed by a committee-appointed review team, by a firm that is a member of the section, or by an association appointed review team. Reviews of association quality control materials may not be performed by a member of the association whose materials are being reviewed. Furthermore, the Committee will not appoint to the QCM review team a person with a firm that is a member of the association or a person or firm that may have a conflict of interest with respect to the QCM review, such as someone who assisted in the development or review of such materials or uses the materials as an integral part of the firm's quality control system.
- .10 A QCM reviewer shall possess the qualifications set forth in the sections entitled "Organization of the Review Team" and "Qualifications for Individuals to Serve as Reviewers" in SECPS §2000.26-.33. A member firm serving as a QCM reviewer must adhere to the guidelines included in "Qualifications for a Reviewing Firm" in SECPS §2000.34-.38. In addition, associations performing QCM reviews must adhere to the guidelines contained in SECPS §3000 "Guidelines for Involvement by Associations of CPA Firms".

**Procedures for Performing OCM Reviews**

- .11 The provider should identify the materials to be reviewed and on which an opinion is to be expressed. A QCM review should include a study and evaluation of the system for the development and maintenance of the quality control materials that have been identified and a review of the materials themselves.

## 2406 Standards for Performing and Reporting on Peer Reviews

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

### STANDARDS FOR REPORTING ON OCM REVIEWS

#### The Review Team's Report

- .14 Within thirty days of the date of the exit conference, the QCM review team should furnish the provider with a written report and, if applicable, a letter of comments.<sup>4</sup>

---

<sup>4</sup> A QCM review team should communicate its findings to the provider organization at an exit conference. For guidance on preparing for and holding an exit conference, see the section entitled "Completion of the Review" discussed in SECPS §2000.91-.92.

**Unmodified Report**

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

**Modified Report**

- .17 The following circumstances ordinarily would require a modified report (including adverse or disclaimed):
- a. The scope of the review is limited by conditions that preclude the application of one or more review procedures considered necessary.
  - b. The provider's system of quality control for the development and maintenance of quality control materials,

**2408 Standards for Performing and Reporting on Peer Reviews**

as designed, did not provide user firms with reasonable assurance that reliable aids had been developed to assist them in conforming with those professional standards the materials purport to encompass.

- c. The degree of compliance with the provider's system of quality control for the development and maintenance of quality control materials was not sufficient to provide user firms with reasonable assurance that reliable aids had been developed to assist them in conforming with those professional standards the materials purport to encompass.
  - d. The resultant quality control materials are not reliable aids to assist user firms in conforming with those professional standards the materials purport to encompass.
- .18 In those instances in which the QCM review team determines that a modified report is required, all the reasons should be disclosed and the QCM review team should consult with the Committee prior to the issuance of the report.

**Letter of Comments**

- .19 A letter of comments issued by a QCM review team should include the following:
- a. A reference to the report and, if applicable, an indication that the report was modified.
  - b. The reviewer's findings, including sufficient detail with respect to the quality control materials so that user firms can determine the actions they need to take, if any, to overcome the effects of the deficiencies noted.
  - c. A statement that the matters discussed in the letter were considered in determining the opinion on the system for the development and maintenance of the quality control materials and the resultant materials.
- .20 If any of the matters to be included in the letter were included in the letter issued in connection with the provider's previous QCM review, that fact ordinarily should be noted in the description of the matter. In addition, although not required, the QCM review team may indicate how corrective action might be implemented. The letter may also include comments concerning actions taken, in process, or to be taken by the provider.
- .21 The letter of comments should include appropriate comments regarding the design of the provider's system of quality

- control for the development and maintenance of the quality control materials, or its compliance with that system, or deficiencies noted in the resultant quality control materials.<sup>5</sup>
- .22 Appendix B, SECPS §2400.26, illustrates how some of the foregoing matters may be covered in a letter of comments.
- .23 If a modified report is issued, the letter must include a separate section on the matters that resulted in the modification. This section would include an elaboration of the findings discussed in the modifying paragraph of the report.

**Letter of Response**

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

---

<sup>5</sup> For guidance on evaluating whether a matter should be included in a letter of comments, see SECPS §2000.118-.119.

2410 Standards for Performing and Reporting on Peer Reviews

.25 APPENDIX A—Sample Form for An Unmodified Report

April 15, 19\_\_

Executive Board  
XYZ Organization

We have reviewed the system of quality control for the development and maintenance of (identify each item covered by the opinion or refer to an attached listing) ("materials") of XYZ Organization (the organization) in effect for the year ended December 31, 19\_\_ and the resultant materials in effect at December 31, 19\_\_ in order to determine whether the materials are reliable aids to assist users in conforming with those professional standards the materials purport to encompass. [The organization has not undertaken the responsibility for maintaining the currency and relevancy of the quality control materials.]<sup>1</sup> The design of the system, and compliance with it, are the responsibilities of the organization. Our responsibility is to express an opinion on the design of the system, and the organization's compliance with that system based on our review.

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

---

<sup>1</sup> To be included if the provider has not undertaken the responsibility for maintaining the currency and relevancy of the quality control materials. In this circumstance, all references to "maintenance" of the quality control materials should be deleted from the report and letter of comments.



affects the degree of compliance with prescribed quality control policies and procedures. Therefore, adherence to all policies and procedures in every case may not be possible. [As is customary in a review of quality control materials, we are issuing a letter under this date that sets forth comments related to certain policies and procedures or compliance with them or to the resultant materials. None of these matters were considered to be of sufficient significance to affect the opinion expressed in this report.]<sup>2</sup>

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

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

---

ABC & Co.<sup>3</sup>

---

<sup>2</sup> To be included if the QCM review team issues a letter of comments along with the unmodified report.

<sup>3</sup> The report should be signed by the reviewing firm for firm on firm reviews or by the team captain for reviews by committee appointed review teams and reviews by an association-sponsored review team.

**2412 Standards for Performing and Reporting on Peer Reviews**

**.26 APPENDIX B—Sample Letter of Comments**

April 15, 19\_\_

[Should correspond with date of report]

Executive Board  
XYZ Organization

We have reviewed the system of quality control for the development and maintenance<sup>4</sup> of (identify each item covered by the opinion or refer to an attached listing) ("materials") of XYZ Organization (the organization) in effect for the year ended December 31, 19\_\_ and the resultant materials in effect at December 31, 19\_\_ and have issued our report thereon dated April 15, 19\_\_ (which was modified as described therein).<sup>5</sup> That report should be read in conjunction with this letter.

As a result of our review, we have the following comments that were considered in determining our opinion set forth in our report dated April 15, 19XX, and this letter does not change the report.

**Design of the Quality Control System**

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

**Recommendation for Improvement**—The organization should revise its policies and procedures for the development and maintenance of quality control materials to include procedures for reviewing, summarizing, and analyzing the feedback received on its quality control materials in order to determine whether the materials

---

<sup>4</sup> If the provider has not undertaken the responsibility for maintaining the currency and relevancy of the quality control materials, all references to "maintenance" of the quality control materials should be deleted from the letter of comments.

<sup>5</sup> To be included if a modified or adverse report is issued and should be tailored to fit the circumstances.

require change(s) to provide reasonable assurance that the materials are reliable aids to assist users in conforming with those professional standards the materials purport to encompass.

**Noncompliance with the Quality Control System**

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

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

**Deficiency in the Quality Control Materials**

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

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

---

ABC & Co.<sup>6</sup>

---

<sup>6</sup> The report should be signed by the reviewing firm for firm on firm reviews or by the team captain for reviews by committee appointed review teams and reviews by an association-sponsored review team.

**2414 Standards for Performing and Reporting on Peer Reviews**

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

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

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

**Introduction**

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

**Guidance For User Firms**

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

**2416 Standards for Performing and Reporting on Peer Reviews**

professional personnel in conforming with those professional standards the materials purport to encompass and for integrating those materials into its practice.<sup>7</sup> A user firm should establish a plan for doing these. Such a plan would ordinarily include—

- a. Identifying the materials that personnel must use during the performance of accounting and auditing engagements.
  - b. Tailoring the materials to the firm's practice.<sup>8</sup>
  - c. Communicating the firm's policies and procedures for using the materials to the professional personnel.
  - d. Training the professional personnel in the use of the materials.
5. It is the user firm's responsibility to ensure that its quality control materials remain current and relevant if the provider has not undertaken the responsibility for updating the materials. Where the provider has undertaken such a responsibility, the user firm should monitor that updates are received on a timely basis and are in accordance with those professional standards the updates purport to encompass. In the event that a provider does not undertake the responsibility for updating quality control materials or if a user has not received timely updates, the user firm should establish appropriate quality control policies and procedures to provide it with reasonable assurance of conforming with those recently issued professional standards that the provider's quality control materials do not encompass.

---

<sup>7</sup> Where a firm has acquired quality control materials that have been subjected to a QCM review, the peer reviewer may rely on the results of the QCM review. However, the reviewer must still evaluate whether the firm has appropriately tailored the materials and integrated them into its practice.

<sup>8</sup> The user firm should be aware that the piecemeal utilization of a provider's quality control materials may violate the integrity of the design of the materials.

SECPS Section 2500

GUIDELINES FOR REVIEW OF CONTINUING PROFESSIONAL EDUCATION PROGRAMS

TABLE OF CONTENTS

<u>Section</u>		<u>Paragraph</u>
2500	Guidelines for Review of Continuing Professional Education Programs	
	Introduction . . . . .	.01-.02
	Qualifications of Review Teams . . . . .	.03
	Review Procedures . . . . .	.04
	Reporting on a Review . . . . .	.05

## Guidelines for Review of Continuing Professional Education Programs

### INTRODUCTION

- .01 Associations of CPA Firms authorized to arrange and carry out peer reviews are required to submit to an independent review of the materials that constitute quality control for the development and maintenance of the materials at least once every three years. (Other providers of quality control materials may opt for an independent review of the these materials.) In the event of substantial change in the system or in the resultant materials, the third party provider should consult with the SEC Practice Section Peer Review Committee to determine whether an accelerated review is warranted.
- .02 The following discussion describes the guidelines that a review team should follow in reviewing continuing professional education programs (hereinafter referred to as "CPE programs") that constitute quality control materials.<sup>1</sup>

### QUALIFICATIONS OF REVIEW TEAMS

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

### REVIEW PROCEDURES

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

---

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



**2504            Standards for Performing and Reporting on Peer Reviews**

- b. Obtaining a description of the objectives of the CPE programs.
- c. Reviewing the qualifications (subject matter and instructional design) of the developer(s) and reviewer(s) of the CPE programs.
- d. Obtaining evidence that the CPE programs were reviewed by qualified person(s) other than the developer(s).
- e. Reviewing and evaluating the procedures established for updating the CPE programs to ensure that they remain current and relevant and for communicating any relevant changes in professional standards to program participants should new professional standards be issued prior to updating the CPE programs.
- f. Reviewing the system developed for soliciting and evaluating feedback on the CPE programs.
- g. Testing documentation evidencing compliance with the system.
- h. Reviewing selected instructor and participant manuals and evaluating whether the materials appear to accomplish the program's objectives.
- i. Evaluating whether the applicable AICPA standards for CPE program development and presentation that are not covered by the preceding procedures are being achieved. (See SECPS §8000.33-.49, "Requirements for Formal Continuing Professional Education Program Development and Presentation".)

**REPORTING ON A REVIEW**

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



**Guidelines for Writing Letters on Monitoring Actions  
By Outside Parties**

**INTRODUCTION**

- .01 A peer review report, letter of comments, and the firm's response to all matters discussed in the report and letter of comments may be accepted by a report acceptance body with the understanding that the firm will allow the team captain or another party acceptable to the Committee (hereinafter referred to collectively as "outside party") to monitor the implementation of certain corrective actions ("monitoring procedures") taken by the firm. In such situations, the reviewed firm will have to engage an individual outside of the firm to perform those monitoring procedures and to allow the outside party to communicate the conclusions reached during the performance of the procedures to the report acceptance body.
- .02 The purpose of these guidelines is to provide assistance to outside parties engaged to monitor one or more corrective actions taken by a reviewed firm as a result of a peer review -- other than an accelerated peer review. If the report acceptance body requires the reviewed firm to have an accelerated peer review, or the firm elects to have such an accelerated review as an alternative to completing other actions required by the report acceptance body, then the reviewed firm and the reviewer should adhere to the "Standards For Performing and Reporting on Peer Reviews" (see SECPS §2000).

**OBJECTIVES**

- .03 The objective of the monitoring actions is to determine whether the firm took one or more actions it agreed to as a result of a peer review and is not intended to be a substitute or a replacement for a full scope peer review. While the procedures performed may not be sufficient to enable the outside party to express an opinion on whether the corrective action achieved the goal for which it was designed or whether the action has been implemented in all required situations, they should be sufficient to provide the outside party with reasonable assurance about whether the firm implemented the action(s) to which it agreed in the situations tested.
- .04 At the conclusion of the monitoring procedures, the outside party should issue a letter that describes the procedures performed and the conclusions reached as a result of those procedures. The letter should be sufficiently comprehensive -- but concise -- to enable the report acceptance body to conclude on the reviewed firm's implementation of the corrective action(s) being monitored. Since the letter will

## **2604 Standards for Performing and Reporting on Peer Reviews**

not be included in a public file, it should be written as a private communication between the outside party and the report acceptance body. However, the outside party should send the reviewed firm a copy of the communication.

### **GENERAL GUIDELINES**

- .05 The outside party should obtain a clear understanding of the corrective actions agreed to by the firm and the monitoring procedures that need to be performed by obtaining a copy of the firm's most recent peer review report, the related letter of comments, the firm's letter of response, and the acceptance letter describing the monitoring actions required by the report acceptance body.
- .06 The outside party should design and perform appropriate procedures to provide him or her with sufficient information to evaluate the reviewed firm's compliance with the corrective action(s) being monitored. In certain circumstances, the outside party may wish to confirm the appropriateness of the procedures to be performed with the staff of the entity administering the review.
- .07 The outside party should summarize the procedures performed and the conclusions reached as a result of those procedures, and discuss those conclusions with the reviewed firm. During the discussions, the outside party should ask whether the firm plans to implement further corrective actions to address any deficiencies noted during the monitoring procedures.
- .08 The outside party should send a letter to the report acceptance body describing the procedures performed and conclusions reached. The letter should be issued on the letterhead of the outside party's firm, addressed to the report acceptance body with a copy to the reviewed firm, and include the following elements:
  - a. A description of the monitoring procedures required by the report acceptance body.
  - b. A description of the representations made by the reviewed firm regarding the corrective actions taken by the firm since its most recent peer review.
  - c. A description of the procedures performed by the outside party.
  - d. A summary of the outside party's findings, including a description of any representations made by the reviewed firm regarding planned corrective actions and the outside party's comments on the appropriateness of those actions. The outside party may consider recommending additional corrective actions or monitoring procedures if he or she

**Guidelines for Writing Letters on Monitoring Actions 2605  
By Outside Parties**

believes the findings reveal continued weaknesses in the reviewed firm's quality control system.

- e. A statement that the letter is intended for limited distribution to the report acceptance body and the reviewed firm, and is not intended as a substitute or replacement for the peer review documents issued by the review team on the firm's peer review.

**ILLUSTRATIVE LETTERS**

- .09 The following letters are for illustrative purposes only. It is recommended, but not required, that the outside party adopt the form of these letters and tailor them to describe the conclusions reached based on the specific procedures performed.

2606 Standards for Performing and Reporting on Peer Reviews

.10 Exhibit A - Sample Letter on an Outside Party's Revisit  
with Recommendation of Further Monitoring Actions

*[Outside Party's Firm Letterhead]*

September 13, 19XX

SECPS Peer Review Committee  
c/o American Institute of Certified  
Public Accountants  
SEC Practice Section  
Harborside Financial Center  
201 Plaza Three  
Jersey City, New Jersey 07311-3881

Dear Committee Members:

This letter is written to assist [Reviewed Firm's Name] in complying with certain actions the firm voluntarily agreed to take in connection with the SECPS Peer Review Committee's acceptance of its 19XX peer review report, letter of comments, and response thereto.

The SECPS Peer Review Committee accepted the firm's 19XX peer review documents with the understanding that the firm agreed to permit an outside party, acceptable to the Committee chair, to:

- a. Review the planning for the firm's 19XX inspection program in advance.
- b. Revisit the firm at the end of its 19XX inspection to review the findings (with emphasis on those items noted in the letter of comments) and the corrective actions taken on the findings noted, and
- c. Provide a written communication on the firm's inspection to the Committee by September 30, 19XX.

Prior to the firm performing its 19XX inspection, I performed the following procedures:

- a. Reviewed a copy of the firm's 19XX peer review report, the accompanying letter of comments and the firm's response thereto, and the acceptance letter describing the required actions.
- b. Reviewed the firm's inspection planning documentation.

**Guidelines for Writing Letters on Monitoring Actions 2607  
By Outside Parties**

I revisited the firm on September 9, 19XX, after the completion of its 19XX inspection. During that revisit, I performed the following procedures:

- a. Discussed the corrective actions described in its letter of response with the firm to determine if the actions have been fully implemented.
- b. Reviewed the firm's inspection report and underlying documentation, including the engagement review checklists prepared during the inspection.
- c. Reviewed the working papers of selected engagements included in the inspection and any changes in the firm's quality control materials to evaluate the effectiveness of the inspection and the corrective actions implemented by the firm as a result of its 19XX peer review.
- d. Discussed the inspection findings and corrective action plan with the firm and evaluated the feasibility of the firm achieving its plan.

Listed below are the results of the procedures I performed and a description of the firm's representations regarding planned corrective actions.

**Letter of Comment Finding No. 1**

This finding related to the firm's failure to issue accountants' compilation reports on monthly computer generated financial statements. The firm's letter of response stated that the firm would revise its quality control policies and procedures to require the issuance of compilation reports with the accompanying financial statements.

**Revisit Results**

The firm adopted a policy requiring the partners to ensure that an accountant's report accompanies compiled financial statements when those statements are issued to the client. The inspection results indicated that compilation reports were issued with monthly compiled financial statements. However, some of the reports did not disclose that the cash basis of accounting was used. This deficiency resulted because the firm obtained a copy of the standard compilation report from the reviewer and used it on all of its compiled financial statements. The firm was not familiar with cash basis reporting on SSARS engagements and did not have any third party reference material. In addition, the firm had not taken any training courses relating to SSARS engagements.

## **2608 Standards for Performing and Reporting on Peer Reviews**

### **Planned Corrective Actions**

The firm implemented a reviewer checklist to provide assurance that the proper type of compilation report will be issued and its policies and procedures were revised to require completion of this checklist. In addition, the firm represented that all personnel involved in preparing and/or reviewing compilation engagements will take 8 hours of CPE in SSARS within the next month. To assess the effectiveness of using the new checklist, the firm represented that it plans to review a sample of compilation reports issued subsequent to the implementation of the checklist.

### **Letter of Comment Finding No. 2**

The firm performed an audit of a defined benefit pension plan subject to ERISA requirements. The firm failed to test investments and did not obtain a representation letter from its client or the plan administrator. The firm subsequently obtained the missing representation letter and performed tests of the investments which I reviewed before the firm's peer review documents were presented to the Committee for acceptance. The firm's letter of response indicated it would obtain an industry specific audit program and update its library to include the AICPA Audit and Accounting Guide for Audits of Employee Benefit Plans.

### **Revisit Results**

The firm did not obtain a copy of the ERISA Audit and Accounting Guide and my review of the ERISA audit showed an industry specific audit program was not obtained and used by the firm on the audit. In addition, some key confirmations relating to investment balances were not obtained and alternative procedures were not performed. The partner with responsibility for the engagement indicated that the firm obtained a large new client that took up a lot of time, and as a result, the staff rushed through the ERISA audit using the prior year's working papers.

### **Planned Corrective Actions**

The firm represented that the ERISA Audit and Accounting Guide and the ERISA industry specific audit program have now been ordered from the AICPA. The firm has subsequently obtained confirmations and/or performed alternative procedures to substantiate the investment balances. I have reviewed the additional procedures performed and they are appropriate. In addition, the firm represented that it plans to send its audit staff responsible for conducting ERISA engagements to 8 hours of training in ERISA audits.



**Guidelines for Writing Letters on Monitoring Actions 2609  
By Outside Parties**

**Letter of Comment Finding No. 3**

The firm performed several audits subject to the requirements of the Single Audit Act. The firm failed to issue the required reports on internal controls and compliance with laws and regulations, did not document its consideration and testing of the internal control structure, and did not perform the necessary procedures to test compliance with laws and regulations. In addition, the partner responsible for the engagement was not in compliance with the "Yellow Book" CPE requirement. The firm performed the omitted audit procedures and issued the missing reports which I reviewed prior to the Committee's acceptance of the firm's peer review documents. The firm's letter of response stated that the partner would take the necessary CPE.

**Revisit Results**

My review of a Single Audit Act engagement performed subsequent to the firm's peer review noted that all required reports were issued on the engagement and that the partner participated in the necessary CPE. However, I was unable to determine the extent of the testing for compliance with laws and regulations because of significant documentation deficiencies. In addition, documentation deficiencies continued to exist with respect to considering and testing the entity's internal control structure and testing for compliance with the requirements applicable to the federal financial assistance programs.

**Planned Corrective Actions**

The firm represented that it plans to conduct a training session for partners and staff during the next month on documentation of audit procedures performed. In addition, the firm represented that it will instruct partners to focus on documentation during their review process and will amend the partner review checklist to add this focus.

**Summary**

The firm's inspection appears to have been comprehensive, suitably designed and adequately documented, and the results appear to have been effectively communicated to professional personnel. However, I believe the Committee should further monitor the firm's corrective actions since the results of these procedures revealed that the firm has failed to adequately implement the corrective actions described in its letter of response. I recommend that the Committee consider requiring the firm to hire an outside third party, who is sufficiently experienced in the industries in which the firm's clients operate, to perform a preissuance review of all of the firm's audit engagements in specialized industries.

**2610 Standards for Performing and Reporting on Peer Reviews**

This letter is intended solely for the information and use of the SECPS Peer Review Committee and the partners of [Reviewed Firm's Name], and is not intended as a substitute or replacement for the peer review documents issued by the review team on the firm's 19XX peer review.

Sincerely,

[Outside Party's Signature]

cc: [Reviewed Firm's Name]

**Guidelines for Writing Letters on Monitoring Actions  
By Outside Parties**

2611

**.11 Exhibit B - Sample Letter on an Outside Party's Review of a  
Subsequent Engagement with Recommendation of No Further  
Monitoring Actions**

*[Outside Party's Firm Letterhead]*

July 21, 19XX

SECPS Peer Review Committee  
c/o American Institute of Certified  
Public Accountants  
SEC Practice Section  
Harborside Financial Center  
201 Plaza Three  
Jersey City, New Jersey 07311-3881

Dear Committee Members:

This letter is written to assist [Reviewed Firm's Name] in complying with certain actions the firm voluntarily agreed to take in connection with the SECPS Peer Review Committee's acceptance of its 19XX peer review report, letter of comments, and response thereto.

The SECPS Peer Review Committee accepted the firm's 19XX peer review documents with the understanding that the firm agreed to permit an outside party, acceptable to the Committee chair, to review the report, financial statements, and working papers of an audit engagement issued subsequent to the firm's peer review, and communicate to the Committee in writing on the results of that review by July 31, 19XX.

I performed the following procedures:

- a. Reviewed a copy of the firm's 19XX peer review report, the accompanying letter of comments and the firm's response thereto, and the acceptance letter describing the required actions.
- b. Reviewed the report, financial statements, and working papers for a not-for-profit audit engagement issued subsequent to the peer review to determine whether the engagement was performed in accordance with professional standards in all material respects. I documented my review using the Division for CPA Firm's "Checklist for Review of Audit Engagements of Not-for-Profit Organizations."

**2612 Standards for Performing and Reporting on Peer Reviews**

- c. Discussed the findings and the corrective action plan with the firm and evaluated the feasibility of the firm achieving its plan.

While performing the above procedures, I found some minor incomplete disclosures in the areas of promises to give and collections. The firm's letter of comments on the most recent peer review also cited disclosure deficiencies; however, they were in other areas. The firm represented that it will conduct a "refresher" training session on disclosures for all partners and professional staff and also will instruct partners to focus on disclosures during their review process.

Because only minor deficiencies were found on the engagement I reviewed, I believe no further monitoring of the firm by the SECPS Peer Review Committee is necessary at this time.

This letter is intended solely for the information and use of the SECPS Peer Review Committee and the partners of [Reviewed Firm's Name], and is not intended as a substitute or replacement for the peer review documents issued by the review team on the firm's 19XX peer review.

Sincerely,

---

*[Outside Party's Signature]*

cc: [Reviewed Firm's Name]

Section III  
ASSOCIATIONS

TABLE OF CONTENTS

Section

3000	Guidelines for Involvement by Associations of CPA Firms
------	---



**INTRODUCTION**

- .01 The objective of these guidelines is to establish procedures under which an association of CPA firms or its member firms may conduct SEC practice section (SECPS) peer reviews of an association-member firm that will meet the SECPS's peer review requirements. Such reviews will meet the requirements of the SECPS if they are conducted in accordance with SECPS §2000, "Standards for Performing and Reporting on Peer Reviews" and this section.
- .02 As used in this section, *associations of CPA firms* includes any association, network, or alliance of accounting firms. The term also applies to two or more firms or a group of firms (whether a formal or informal group) that jointly market or sell services.

**INDEPENDENCE**

- .03 The association and its member firms must meet the following independence criteria:
- a. The association, as distinct from its member firms, does not perform any professional services other than those it provides to its member firms or affiliates.
  - b. The association does not make representations regarding the quality of professional services performed by its member firms to assist member firms in obtaining engagements, unless the representations are objective or quantifiable. However, member firms may independently publicize their membership in the association. In addition, an association may respond to inquiries and prepare promotional materials that firms may use to obtain professional engagements on their own behalf.
  - c. Referral or participating work among member firms is arranged directly by the firms involved.
  - d. The association does not have any direct or material indirect financial interest or involvement in its member firms in sharing fees generated by members through the sale of product or services.
  - e. The association does not have any direct or material indirect financial interest or involvement in its member firms in sharing fees generated by members through the sale of products or services.

## 3004 Guidelines for Involvement by Associations of CPA Firms

- f. The association does not exercise any direct or indirect management control over the professional or administrative functions of its member firms.

### PLAN OF ADMINISTRATION

- .04 Annually, the association must file a plan of administration with the AICPA Practice Monitoring Department to be accepted by the SECPS Peer Review Committee (the Committee) prior to the association or its members performing any peer reviews of other member firms during that year.

### ASSOCIATION QUALITY CONTROL MATERIALS<sup>1</sup>

- .05 In the event that materials used by its members constitute association quality control materials, the association shall arrange for an independent triennial review of those materials and related system of quality control.<sup>2</sup> The report resulting from the review of the materials, the letter of comments, if any, and the letter of response thereto, are placed in the public files upon acceptance by the Committee and should be made available to the association member firms.

### REVIEWS CONDUCTED BY AN ASSOCIATION

- .06 In addition to fulfilling the preceding requirements, an association (as contrasted to its member firms) may conduct peer reviews of its member firms if the association (1) establishes policies and procedures to ensure that the reviews are conducted in a manner consistent with the SECPS peer review standards, (2) requires that a majority of the review team members, including the team captain, be from association member firms, and (3) submits to triennial administrative reviews.

---

<sup>1</sup> See Appendix A, SECPS §3000.09, "Interpretation: Association Quality Control Materials", for a discussion of association quality control materials.

<sup>2</sup> See SECPS §2400, "Standards for Performing and Reporting on Reviews of Quality Control Materials", or SECPS §2500, "Guidelines for Review of Continuing Professional Education Programs".



## Guidelines for Involvement by Associations of CPA Firms 3005

- .07 The initial triennial administrative review should be performed during the second year that the association conducts peer reviews of its member firms under the SECPS peer review program. Such administrative reviews may be performed by a committee-appointed review team or by a firm that is a member of SECPS provided that such firm is not a member of the association under review. The review team shall possess the same qualifications as those required for review teams on peer reviews.

### OVERSIGHT

- .08 The Committee and the Public Oversight Board have the right to monitor an association's administrative and/or review activities relating to the peer review program and to review the work of an individual review team.

## 3006 Guidelines for Involvement by Associations of CPA Firms

### .09 APPENDIX A-Interpretation: Association Quality Control Materials

#### Definition

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

#### Examples of Association Quality Control Materials

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

**Guidelines for Involvement by Associations of CPA Firms 3007**

**.10 APPENDIX B-Sample Unmodified Report on Review of Association  
Peer Review Program Administrative Procedures**

May 15, 19\_\_

Executive Committee  
XYZ Association

We have reviewed the procedures of XYZ Association in effect for the year ended December 31, 19\_\_ for conducting peer reviews of association-member firms under the authorization of the peer review committee of the SEC Practice Section of the AICPA Division for CPA Firms (the Section). Our review was conducted in accordance with the Section's Program for Monitoring Authorized Association Peer Reviews and included tests of the association's compliance with the Section's "Guidelines for Involvement by Associations of CPA Firms". (As is customary in such reviews, we are issuing a letter under this date that sets forth comments related to certain procedures or compliance with them. None of these matters were considered to be of sufficient significance to affect the opinion expressed in this report).<sup>1</sup>

In our opinion, the procedures of XYZ Association in effect for the year ended December 31, 19\_\_, have been designed to meet the "Guidelines for Associations of CPA Firms" and were being complied with during the year then ended to provide the Section with reasonable assurance that peer reviews are conducted in a manner consistent with the SECPS peer review standards.

---

John Doe  
Team Captain

or

Brown & Co. (Firm conducted review)

---

<sup>1</sup> To be included if the review team issues a letter of comments along with the unmodified report.

Section V

ADMINISTRATION

TABLE OF CONTENTS

Section

5000      Administrative Procedures of the SECPS Peer Review  
            Committee

**ADMINISTRATIVE PROCEDURES OF THE SECPS PEER REVIEW COMMITTEE**

**TABLE OF CONTENTS**

<u>Section</u>	<u>Paragraph</u>
5000 Administrative Procedures of the Peer Review Committee	
Introduction .....	.01-.02
Source of Reviewers .....	.03-.05
Committee-Appointed Review Teams .....	.03
Firm-on-Firm Reviews .....	.04
Association Reviews .....	.05
Evaluation of Reviewers .....	.06-.07
Arranging Reviews .....	.08-.15
Committee-Appointed Review Teams .....	.09-.13
Firm-on-Firm Reviews .....	.14
Association Reviews .....	.15
Performing Reviews .....	.16-.28
Reporting on Reviews .....	.18-.22
Review Team Working Papers .....	.23-.28
Committee-Appointed Review Teams .....	.23
All Other Reviews .....	.24
Retention Period .....	.25-.28
SEC Access to Working Papers .....	.29
Terminated Reviews .....	.30-.31
Files .....	.32-.33
Fees and Expenses .....	.34-.38
Committee-Appointed Review Teams .....	.34-.37
All Other Reviews .....	.38
Evaluating the Review Process .....	.39-.46
General Considerations .....	.39
Oversight Panels .....	.40-.46
 Appendixes	
A - Sample Engagement Letter .....	.47
B - Peer Review Fees .....	.48
C - Reviewer's Responsibilities When Performing SECPS Peer Reviews .....	.49

**INTRODUCTION**

- .01 This section sets forth the procedures to be followed in administering the SEC Practice Section Peer Review Program. They have been approved by the Peer Review Committee of the SEC Practice Section.
- .02 Peer reviews may be conducted by a review team that meets any of the following criteria:
  - a. Appointed by the Committee (a "CART" review).
  - b. Formed by a member firm engaged by the firm to be reviewed (a "firm-on-firm" review).
  - c. Formed by an association of CPA firms authorized by the Committee to perform peer reviews.

**SOURCE OF REVIEWERS**

**Committee-Appointed Review Teams**

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

**Firm-on-Firm Reviews**

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

## 5004 Administrative Procedures of the SECPS Peer Review Committee

to conduct a review.<sup>1</sup>

### Association Reviews

- .05 A list is maintained of organizations authorized to arrange and carry out peer reviews, such as associations of CPA firms. This list is updated whenever the Committee approves a new or updated plan pursuant to the guidelines included in SECPS §3000.

### EVALUATION OF REVIEWERS

- .06 All reviewed firms will be asked to evaluate the effectiveness of the peer review program and the performance of the review team. In addition, the performance of team captains will be subject to evaluation by the SECPS Peer Review Committee. Any such evaluation will be communicated to the team captain.<sup>2</sup>
- .07 At the conclusion of each review by a committee-appointed review team, the team captain will evaluate the performance of each team member.

### ARRANGING REVIEWS

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

---

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

<sup>2</sup> See Appendix C, SECPS §5000.49, "Reviewer's Responsibilities When Performing SECPS Peer Reviews."

**Committee-Appointed Review Teams**

- .09 The staff will request relevant background information from firms that are scheduled to have a review during the year, or from firms that request a review.
- .10 After receipt of the background information, a team captain and team members, if any, will be selected by the staff from the national data bank of reviewers. In selecting review team members, consideration will be given to their experience with practice units of comparable size and types of practice. Review team members will be asked if they know of any reason why it would be inappropriate for them to participate in the review. Subsequent changes in team members or the addition of consultants to the review team are to be made only by the team captain with the concurrence of the staff.
- .11 The staff will prepare the engagement letter that will include the range of hours anticipated to complete the review and the hourly rate to be charged for each member of the review team. After the engagement letter is prepared it will be sent to the firm for signature. This will ordinarily take place approximately four to six weeks before the review is scheduled to begin. This is usually adequate advance notice, since the review is generally scheduled for the week requested by the firm. A sample engagement letter is shown in Appendix A, SECPS §5000.47.
- .12 In the engagement letter, the reviewed firm will be advised of the names of the reviewers and their firms. If it believes there is a conflict of interest, the reviewed firm will have the opportunity to request reconsideration of any proposed team member.
- .13 Generally, a reviewer will be selected from outside the state or geographical area in which the reviewed firm practices. However, the reviewed firm may waive this consideration.

**Firm-on-Firm Reviews**

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



Association Reviews

- .15 If a member firm elects to have its review arranged and carried out by an association of CPA firms, the reviewed firm must notify the staff prior to the commencement of the review and must furnish a copy of that notification to the association. The association must have a plan of administration that has been approved by the Committee.<sup>3</sup> The review must be conducted in accordance with the approved plan of administration and with the standards for performing and reporting on peer reviews. The Committee reserves the right to approve the reviewers on association reviews.

PERFORMING REVIEWS

- .16 The standards for performing and reporting on peer reviews indicate that situations may arise that require the review team to consult with the Peer Review Committee or its staff. Examples of such situations are as follows:
- a. The issuance of a modified report (including adverse reports - see §2100.01) is being considered.
  - b. When there is any uncertainty about whether a letter of comments should be issued.
  - c. Consideration is being given to terminating the review.
  - d. Difficulties are encountered or circumstances appear to require a departure from the peer review standards for example, in selection of engagements for review.
  - e. The review team encounters a situation where it and the reviewed firm disagree about whether there is a need to take action to prevent future reliance on a previously issued report, pursuant to the AICPA Professional Standards, vol. 1, AU section 561.
  - f. The review team encounters a situation where it and the reviewed firm disagree about whether there is a need for additional auditing procedures to provide a satisfactory basis for a previously expressed opinion, pursuant to the AICPA Professional Standards, vol. 1, AU section 390,

---

<sup>3</sup> See SECPS §3000 for guidance regarding the procedures established by the Committee to authorize other organizations to arrange and carry out peer reviews.

"Consideration of Omitted Procedures After the Report Date".

- g. The review team encounters a situation where it and the reviewed firm disagree about whether the firm had a reasonable basis under the standards for accounting and review services for the report issued.
  - h. The review team encounters difficulties in selecting a reasonable cross section of the firm's accounting and auditing practice based on the engagement selection criteria set forth in the peer review standards.
- .17 If the review team encounters one of the above situations, the team captain should consult with the staff who, if the matter cannot be resolved, will arrange a consultation with a member of the Committee.

#### Reporting on Reviews

- .18 SECPS §2000.98, "Standards for Performing and Reporting on Peer Reviews," provides that, within 30 days of the date of the exit conference, the team captain will submit to the reviewed firm the team's report and letter of comments, if any.<sup>4</sup> The team captain should notify the staff when the review has been completed and the report and letter, if any, have been issued.
- .19 The standards also provide that the reviewed firm will be responsible for submitting to the Committee a copy of the report, the letter of comments, and its response thereto within 15 days of the date the report and letter were issued.
- .20 The reviewed firm is also responsible for submitting a draft of the letter of response to the team captain for review and comment prior to submitting the letter of response to the Peer Review Committee. When submitting the peer review documents to the Committee, the reviewed firm should also confirm in writing that 1) a draft of the letter of response was sent to the team captain, 2) the draft was discussed with the team captain, and 3) appropriate actions were taken on the comments, if any, received from the team captain on the draft.
- .21 The staff will notify the reviewed firm and team captain by letter when the report and, if applicable, letter of comments and response thereto, have been accepted by the Committee and

---

<sup>4</sup> See Appendix G, SECPS §1000.41, "Organizational Structure and Functions of the SEC Practice Section of the AICPA Division for CPA Firms."

**5008 Administrative Procedures of the SECPS Peer Review Committee**

placed in the public files. The reviewed firm should not release copies of the report, letter of comments, or response thereto to its personnel, its clients, or others until it has been advised that these documents have been accepted by the Committee.

- .22 A member of the Committee or the staff may make such inquiry (before, during, or after the review) into the scope and conduct of the review as is deemed necessary in the circumstances.

**Review Team Working Papers**

**Committee-Appointed Review Teams**

- .23 Concurrent with the issuance of the report, which should be within 30 days of the exit conference, the team captain should send the working papers to the AICPA SEC Practice Section Team at the AICPA's New Jersey office by an insured carrier. The files should be segregated as follows and should be sent under separate cover:

- a. Engagement review checklists, engagement-related "Matter for Further Consideration" forms, and supporting materials relating to individual clients
- b. Remainder of working papers, including office and firm-wide summary review memorandums and summary engagement checklists.

**All Other Reviews**

- .24 Working papers for firm-on-firm reviews should be retained by the reviewing firm. Working papers prepared by review teams appointed by authorized associations should be retained by the respective association. In both cases, within 30 days of the date of the exit conference, unless other arrangements have been made with the AICPA's SEC Practice Section Team or the staff of the Public Oversight Board, the team captain should send the working papers to the AICPA SEC Practice Section Team at the AICPA's New Jersey office by an insured carrier. The files should be segregated as follows and should be sent under separate cover:

- a. Engagement review checklists, engagement-related "Matter for Further Consideration" forms, and supporting materials relating to individual clients.
- b. Remainder of working papers, including office and firm-wide summary review memorandums and summary

engagement checklists.

All working papers are subject to review by the Committee, the staff, the Public Oversight Board, and, if applicable, the SEC. (See SECPS §5000.29, "SEC Access to Working Papers.") The team captain should notify the staff of when and where the working papers will be available for review.

### Retention Period

- .25 To enable the Peer Review Committee and the Public Oversight Board to exercise their oversight responsibilities, all working papers, reports, and letters prepared during an SECPS peer review, with the exception of those described in paragraphs .26-.28 below, should be retained by the entity that formed the review team for a period of ninety days after the date on which the SECPS Peer Review Committee has accepted the peer review report<sup>5</sup> (and, if applicable, the letter of comments and the response thereto) unless the committee indicates that certain working papers should be retained for a longer period of time because the firm has been required to take certain corrective actions for which the working papers, reports and letters may be required.
- .26 The following peer review documents should be retained by the entity that formed the review team, from the date of a peer review until the subsequent review required for continued membership or until the time for such review has elapsed:
- a. The peer review report.
  - b. The letter of comments and the firm's response thereto, if applicable.
  - c. The letter accepting the peer review report.
  - d. The letter documenting the firm's compliance with actions taken as a result of the committee consideration of the peer review report.
- .27 In addition, the administering entity may also wish to consider retaining documents which relate to the business of arranging the peer review, such as:

---

<sup>5</sup> If the peer review is intended to meet the requirements of the Federal Deposit Insurance Act, the review team should retain the working papers for a period of 120 days after the date that the reviewed firm files the peer review documents with the Federal Deposit Insurance Corporation.

**5010 Administrative Procedures of the SECPS Peer Review Committee**

- a. Engagement letters,
  - b. Scheduling information forms,
  - c. Team appointment acceptance letters, and
  - d. Extensions requests.
- .28 Notwithstanding the above, all working papers should be retained for as long as any of the following are in process:
- a. Review by the SEC staff.
  - b. Resolution of a disagreement between the reviewed firm and the review team.
  - c. Activities of an oversight or evaluation panel assigned to the review.
  - d. The sanction process, including actions by both the SECPS Peer Review Committee and the SECPS Executive Committee.
  - e. The appeal of any decision of the SECPS Peer Review Committee or the SECPS Executive Committee as long as such appeal was initiated in accordance with rules established by these committees.
  - f. Review by the FDIC staff.

**SEC ACCESS TO WORKING PAPERS**

- .29 With respect to reviews of member firms with one or more SEC clients, the following procedures have been established to enable the SEC to make its own evaluation of the adequacy of the peer review process and the Public Oversight Board's oversight of that process, giving appropriate consideration to the obligation of reviewed firms and review teams to maintain the confidentiality of client information.
- a. Within fifteen business days after the SECPS Peer Review Committee accepts a report on a review of a member firm with one or more SEC clients, the Public Oversight Board will notify the SEC chief accountant in writing of that fact. However, that notification will use code numbers for reviewed firms that audit fewer than ten SEC clients.
  - b. If the SEC chief accountant wants the staff to review the peer review working papers relating to one or more of the reviews [see (a) above], the SECPS Peer Review Committee

chair and the Public Oversight Board must be notified, in writing, regarding which review or reviews. The notification must be made within 30 days after the chief accountant of the SEC has been notified by the Public Oversight Board that the SECPS Peer Review Committee has accepted the report, and must include a representation that the review is not made pursuant to a formal or informal investigation by the SEC of the reviewed firm or any of its clients. The SEC chief accountant's staff ordinarily should complete the review of the peer review working papers within 90 days after the date of the SEC chief accountant's notification to the SECPS Peer Review Committee chair and the Public Oversight Board.

- c. With respect to member firms that have one or more SEC clients, the SEC chief accountant's staff will have access to the following peer review working papers that will be coded so as not to reveal the identity of the reviewed firm if it has less than ten SEC clients:
  - 1. Firm-wide summary memorandum.
  - 2. Summary memorandum for each office reviewed for a multi-office firm.
  - 3. Combining working papers showing the trail from the office memorandums to the firm-wide memorandum for a multi-office firm.
  - 4. The working papers relating to the review of functional areas.
  
- d. With respect to member firms that have permanent representation on the SECPS Executive Committee, at the SEC chief accountant's option and in lieu of c.2 and c.3, his staff may have access to:
  - 1. All "Matter for Further Consideration" (MFC) forms.
  - 2. Firm-wide summary of MFCs.
  - 3. Firm-wide summary of answers to engagement checklists.
  - 4. Those portions of the office summary memorandums relating to the review of functional areas.
  
- e. Peer review engagement working papers will be retained until the SEC chief accountant's staff has completed its review so that questions relating to the peer review

5012 Administrative Procedures of the SECPS Peer Review Committee

raised by the staff can be answered.

- f. If the SEC chief accountant's staff has any matters it believes the SECPS Peer Review Committee should consider, the staff will discuss them with representatives of the Public Oversight Board and the SECPS Peer Review Committee.
- g. The SEC is not permitted to retain any peer review working papers nor any copies thereof.

**TERMINATED REVIEWS**

- .30 The standards for performing and reporting on peer reviews provide that a review may not be terminated without the prior approval of the SECPS Peer Review Committee chair or his designee. They also require that the SECPS Peer Review Committee be notified by the review team in writing when a review is terminated and that the substantive reasons for the termination be given. In some circumstances, the SECPS Peer Review Committee may wish to inquire further into the reasons for the termination and to supplement the record with a memorandum of that inquiry. Termination of a review will not be approved when the review team has noted significant deficiencies related to engagements.
- .31 When a review is terminated during its very preliminary stages and no substantive review work is accomplished, a letter of termination is not necessary. However, the team captain must notify the AICPA SEC Practice Section staff that the review is being terminated and the reasons therefor.

**FILES**

- .32 The SEC Practice Section's files will be maintained at the AICPA's New Jersey office, classified as follows:

<u>Available for Public Inspection</u>	<u>Not Available for Public Inspection</u>
The firm's membership application and related documents (for example, waiver of or extension for compliance with a membership requirement)	Administrative files Working papers
The firm's three most recent annual reports	Oversight memorandum(s) and related working papers
An organization's request for SECPS	

**Administrative Procedures of the SECPS Peer Review Committee 5013**

Peer Review Committee authorization to administer a peer review program and the grant thereof

SECPS Peer Review  
Committee's  
recommendations of  
sanctions to the  
SECPS Executive  
Committee

Report on peer review

Report on review of association quality control materials

Letter of comments and the reviewed firm's response thereto

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

Report on association administrative review Letter of comments resulting from an association administrative review and the response thereto

Information concerning actions taken as a result of SECPS Peer Review Committee consideration of the peer review report

SECPS Peer Review Committee letter of acceptance

Information concerning sanctions imposed by the SECPS Peer Review Committee Executive Committee, if any

Notification of termination of review, if applicable

Letter of termination

The firm's letter of resignation and the acceptance thereof

.33 Documents relating to a peer review will be retained until completion of the subsequent review or until the time for such review elapsed. Public files of a firm whose membership has been terminated, either by resignation or by action of the SECPS Executive Committee, will be available for public inspection for a period not to exceed three years from the date of such termination. Also, the administrative file of a firm whose membership has been terminated, either by resignation, or by action of the SECPS Executive Committee, will be retained for a period not to exceed three years from the date of such termination.



5014 Administrative Procedures of the SECPS Peer Review Committee

FEEES AND EXPENSES

Committee-Appointed Review Teams

- .34 Fees will be charged to the reviewed firm at rates established by the committee; such rates are based upon the average standard billing rates of reviewers who have been included in the national data bank of reviewers. The rates are periodically reviewed by the committee to ensure their suitability.
- .35 The billing rates will vary based on the size of the reviewed firm. (See Appendix B, SECPS §5000.48.) Separate rates are established for.
- a. The team captain.
  - b. The review team members who are partners.
  - c. The review team members who are not partners.
- .36 All out-of-pocket expenses, such as those for travel and subsistence, will be billed to the reviewed firm at actual cost. The procedures for submitting bills are as follows:
- a. The team members should submit their bills for time and expenses to the team captain for approval
  - b. Within 30 days of the date of the exit conference, the captain should submit the approved bills, together with his own, to the AICPA.
- .37 AICPA staff will use this billing information to prepare and submit its bill to the reviewed firm. Scheduling and evaluation fees will be added to cover the costs of administering the program. (See Appendix B, SECPS §5000.48.) These fees also will be deemed to cover the cost of inquiry into the performance of committee-appointed review teams by SECPS Peer Review Committee members or AICPA SEC Practice Section staff, but it does not cover the cost of a required revisit by the review team or an accelerated review deemed necessary as a result of the SECPS Peer Review Committee's consideration of the report, letter of comments, and the firm's response thereto.

All Other Reviews

- .38 For firm-on-firm reviews and reviews arranged and carried out by authorized associations of CPA firms, the respective reviewing entities will make their own fee and billing arrangements. In addition, the reviewed firm will be charged for scheduling and evaluation fees to cover the cost of administering the program. (See Appendix B, SECPS §5000.48.)

EVALUATING THE REVIEW PROCESS

General Considerations

- .39 The SECPS Peer Review Committee is responsible for monitoring and evaluating the SEC Practice Section Peer Review Program. In this regard, the SECPS Peer Review Committee may assign one of its members or a member of the staff to make such inquiry into the scope and conduct of the review as is deemed necessary under the circumstances, including a review of working papers. Such inquiry may be made either while the review is in process or after it is completed.

Oversight Panels

- .40 The SECPS Peer Review Committee may, at its discretion, appoint an oversight panel of one or more persons to evaluate any peer review conducted for purposes of meeting the SEC Practice Section's membership requirements. The objective of an oversight panel is to assist the committee in determining whether a particular peer review was conducted in accordance with the standards for performing and reporting on peer reviews.
- .41 An oversight panel will consider whether the scope and performance of the review in question are in accordance with standards established for such reviews and whether the review team's report conforms to the reporting standards. The panel will also consider the appropriateness of the review team's conclusions and may consult with the review team and/or the reviewed firm concerning differences of professional opinion.
- .42 An oversight panel may perform its work concurrently with or after the conclusion of a peer review and issuance of the review team's report.
- .43 Oversight panel members will be appointed by the SECPS Peer Review Committee or SEC Practice Section staff as directed by the SECPS Peer Review Committee chair. The qualifications

**5016 Administrative Procedures of the SECPS Peer Review Committee**

for panel members are the same as those for team captains. Panel members must also be independent of the reviewed firm and the review team members.

- .44 An oversight panel will report to the SECPS Peer Review Committee orally and/or in writing as directed by the SECPS Peer Review Committee. The panel's memorandum(s) and related working papers, if any, will be for the information of the SECPS Peer Review Committee and will be retained in the nonpublic files.
- .45 If, after the completion of the evaluation, the oversight panel, the reviewed firm, and the team captain all agree with the report originally issued at the conclusion of the review, that report will remain unchanged. If they all agree upon the modifications to be made, a revised report will be issued.
- .46 If the oversight panel, the reviewed firm, and the team captain do not all agree, the matter will be decided by the SECPS Peer Review Committee.

.47 APPENDIX A. Sample Engagement Letter

[For a committee-appointed review team]

(DATE)

(The Managing Partner's Name)

(Firm Name)

(Address)

Re: Review Number

Dear (Managing Partner's Name):

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

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

**Scope of the Review**

The review will be performed in accordance with the Standards for Performing and Reporting on Peer Reviews issued by the AICPA SEC Practice Section Peer Review Committee. Those standards require, among other things, that the review be conducted in compliance with the confidentiality requirements set forth in the AICPA Code of Professional Conduct. Information concerning the firm or any of its clients or personnel that is obtained as a consequence of the review is confidential. Such information shall not be disclosed by reviewer(s) to anyone not involved in carrying out the review or administering the SECPS peer review program or used in any way not related to meeting the objectives of the peer review program. Also, no reviewer(s) will have contact with clients of your firm.

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

**Liability and Subpoena**

You agree not to take, or assist in, any action seeking to hold liable, jointly or singly, us, or the reviewer(s) including any assistants, committees or the reviewer(s) or their firms-for damages on account of any good faith act or omission or on account of any deficiency in the files overall, unless those damages arise from malice, gross negligence, or recklessness, or any violation of the confidentiality standards issued by the AICPA in its Code of Professional Conduct. Also, you agree not to subpoena any of those persons or organizations, or otherwise call them to testify, in any action to which

**5018 Administrative Procedures of the SECPS Peer Review Committee**

they are not a party, with respect to any of the work performed, reports made, or information acquired or developed in connection with this review. However, this provision shall not apply if some other person has done that successfully and you conclude you must do so in response.

**Timing of Review and Fees**

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

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

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

\* \* \* \* \*

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

Sincerely,

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

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

\_\_\_\_\_  
Firm To Be Reviewed

\_\_\_\_\_  
Date

\_\_\_\_\_  
By

\_\_\_\_\_  
Position

**Administrative Procedures of the SECPS Peer Review Committee 5019**

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

**Areas of Experience:**

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

5020 Administrative Procedures of the SECPS Peer Review Committee

.48 APPENDIX B - Peer Review Fees

Committee-Appointed Review Teams

Basic Policy

1. Pursuant to the SECPS Peer Review Committees administrative procedures, the SECPS Peer Review Committee establishes rates annually for committee- appointed review teams. Rates are based upon the average standard billing rates of individuals who have indicated an interest in serving on committee-appointed review teams. The size of the reviewed firm determines the rate to be paid to reviewers. Out-of-pocket expenses are billed at actual cost.

Reviewer Rates

2. The peer review committee has approved the following hourly rates to be paid to members of committee-appointed review teams. (Effective for peer reviews beginning on or after April 1, 1999.)

	<u>Number of Professional Staff in the Reviewed Firm</u>		
	<u>1-10</u>	<u>11-49</u>	<u>50+</u>
Team captain	\$95	\$110	\$130
Team members who are partners	\$85	\$100	\$115
Team members who are not partners	\$75	\$ 90	\$100

Administrative Fees

3. Administrative fees, established by the AICPA, are intended to defray the costs of scheduling and evaluating peer reviews. The scheduling fee covers the costs associated with the selection or approval of a review team and the evaluation fee covers the costs associated with the consideration and acceptance of the results of the review. The fees are assessed to firms in the year of their review and charged on all types of reviews, whether carried out by the committee-appointed review team (a "CART" review), another

firm (a "Firm-on-Firm" review), or under the auspices of an association of CPA firms.

4. The fees for reviews performed on or after April 3, 1995 are as follows:

<u>Size of Firm</u>	<u>Scheduling and Evaluation Fee<sup>1</sup></u>
Sole practitioner with no professional staff	\$ 350
2 to 10 professionals	\$ 650
More than 10 professionals	\$1100
Associations of CPA firms	\$ 150
Providers of Third Party Quality Control Materials	\$ 150

---

<sup>1</sup> A separate scheduling and evaluation fee will be charged for each set of peer review documents submitted, including plans of administration.



**.49 APPENDIX C. Reviewer's Responsibilities When Performing SECPS Peer Reviews**

A peer reviewer has a responsibility to perform a peer review in a timely manner. This relates not only to the initial submission to the AICPA SEC Practice Section Team of the report, letter of comments and working papers on the review, but also to the timely completion of any additional actions necessary to complete the review that are under the control of the reviewer, such as completing omitted documentation of the work performed on the review, or resolving questions raised during the review process by the SECPS Peer Review Committee, the Public Oversight Board, or their respective staffs.

In considering the peer review documents for acceptance, the SECPS Peer Review Committee also evaluates the reviewer's performance on the peer review. If serious deficiencies in the reviewer's performance are noted on a particular review, or if a pattern of deficiencies by a particular reviewer over numerous reviews is noted, then the SECPS Peer Review Committee, depending on the particular circumstances, will consider the need for corrective or monitoring actions on the reviewer. The SECPS Peer Review Committee may require the reviewer to comply with certain actions, such as the following, in order to continue performing reviews:

- o Attendance at a reviewer's training course and receipt of a satisfactory evaluation from the instructor of the course.
- o Committee oversight on the next review performed by the reviewer at the expense of the reviewer's firm (including out-of-pocket expenses, such as travel cost, and per diem charges at the respective CART team captain billing rates established by the section).
- o Completion of all outstanding reviews before accepting an engagement to perform another review.
- o Preissuance review of the report, letter of comments, and working papers on future reviews by an individual who has experience in performing peer reviews.

If corrective or monitoring actions are imposed on a reviewer by the AICPA Peer Review Board, those actions will also apply to SECPS peer reviews performed by the reviewer unless the actions are specific to the other program. In addition, any

condition imposed on a reviewer will apply to the individual service as either a team captain or a team member unless the condition specifically relates to the individual's service as only a team captain or team member.

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

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

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

**Section VI**

**PEER REVIEW COMMITTEE**

**TABLE OF CONTENTS**

**Section**

**6000      SECPS Peer Review Committee Meeting and Voting Procedures**

## SECPS Section 6000

## PEER REVIEW COMMITTEE MEETING AND VOTING PROCEDURES

## TABLE OF CONTENTS

<u>Section</u>	<u>Paragraph</u>
6000 Peer Review Committee Meeting and Voting Procedures	
Introduction . . . . .	.01
Committee Responsibilities and Functions . . . . .	.02-.03
Committee Support . . . . .	.04-.06
Meeting Procedures . . . . .	.07-.16
Conduct of Meetings . . . . .	.07
Alternates to Committee Members . . . . .	.08
Advisors and Observers . . . . .	.09
Privilege of the Floor . . . . .	.10-.11
Quorum Requirement . . . . .	.12
Minutes of Meetings . . . . .	.13
Availability of Documents, Minutes, and Correspondence . . . . .	.14-.15
Meeting Sites . . . . .	.16
Voting Procedures . . . . .	.17-.21
Standards and Interpretations of Standards . . . . .	.17-.19
Other Matters Requiring Committee Approval . . . . .	.20
Abstention From Committee Discussions and Voting . . . . .	.21
Correspondence . . . . .	.22-.23
Appendix—Resolution on Location of AICPA Committee Meetings . . . . .	.24

**Peer Review Committee Meeting and Voting Procedures****INTRODUCTION**

- .01 The Executive Committee of the SEC Practice Section of the AICPA Division for CPA Firms is responsible for implementing the Division's self-regulatory program as it relates to the SEC Practice Section. AICPA Council has designated the Executive Committee as a "senior committee" with authority to make public statements without clearance from Council or the board of directors on matters relating to the program. The Executive Committee appoints the Peer Review Committee (the Committee), which consists of no less than 15 individuals from member firms.

**COMMITTEE RESPONSIBILITIES AND FUNCTIONS**

- .02 As set forth in the Section's organizational document, the Committee shall—
- a. Administer the program of peer reviews for member firms.
  - b. Establish standards for conducting reviews.
  - c. Establish standards for reports on peer reviews and publication of such reports.
  - d. Recommend sanctions and other disciplinary decisions (including whether the name of the affected firm is published) to the Executive Committee.
  - e. Consult from time to time with the Public Oversight Board.
  - f. Keep appropriate records of peer reviews that have been conducted.
- .03 In discharging its responsibilities, the Committee, through its staff, coordinates its activities to the extent necessary with other components of the division and of the AICPA.

**COMMITTEE SUPPORT**

- .04 Staff support for the Committee consists of the AICPA vice president-self-regulation and SEC Practice Section and director of SEC Practice Section appointed by the senior vice president-technical services, and technical managers and assistants authorized by the director.
- .05 Subcommittees and task forces are appointed by the chairman of the Committee to assist the Committee in carrying out its

## **6004 Peer Review Committee Meeting and Voting Procedures**

responsibilities, and their work is subject to review by the Committee.

- .06 A subcommittee is a standing group entirely or partially composed of Committee members. A task force is a group entirely or partially composed of Committee members appointed to undertake a special project and terminates on the completion of its assignment.

### **MEETING PROCEDURES**

#### **Conduct of Meetings**

- .07 Meetings are conducted on an informal basis, rather than in conformity with formal rules of order. Because the work of the Committee is deliberative in nature, a free exchange of ideas is essential. It is believed that adherence to formal rules of order would inhibit that free exchange. However, a meeting held for the purpose of holding a hearing to decide whether to recommend to the Executive Committee that sanctions be imposed on a member firm is subject to the Section's Rules of Procedure for the Imposition of Sanctions. (A copy of the rules will be provided to a member firm when the Committee is deciding whether to conduct such a hearing.)

#### **Alternates to Committee Members**

- .08 Alternates to Committee members may attend meetings as substitutes and, in the absence of the Committee members, will be accorded all member privileges except that they cannot participate in a written ballot on establishment of standards or interpretations or on recommendations for sanctions or other disciplinary actions against a member firm.

#### **Advisors and Observers**

- .09 Representatives of member firms may attend all Committee meetings as advisors to Committee members or as observers by notification to and approval by the Committee chairman, except for the portions of meetings at which peer review reports and related documents are considered for acceptance or recommendations for sanctions or other disciplinary actions against member firms are discussed.

#### **Privilege of the Floor**

- .10 Members of the Committee, their alternates (in the absence of the Committee members), the chairman of the board of the AICPA, the chairman of the Section's Executive Committee, the president of the AICPA, the senior vice president-technical

services, the vice president-self regulation and SEC Practice Section, the director of the SEC Practice Section, the staff aide to the Committee, members of the Public Oversight Board and its representatives, and representatives of the AICPA Peer Review Board have the privilege of the floor during committee meetings. The privilege of the floor also will be extended to chairs of subcommittees and task forces and other AICPA staff when matters relating to their activities are being discussed.

- .11 The chair may grant advisors, observers, representatives of member firms, and reviewers the privilege of the floor, provided a request for such privilege is received sufficiently in advance of the meeting and the specific subject to be discussed is identified.

**Quorum Requirement**

- .12 An official meeting of the Committee will not be held unless at least one-half of the members are present, excluding alternates.

**Minutes of Meetings**

- .13 The staff will prepare minutes of Committee meetings setting forth principal actions taken and decisions reached. The minutes will be submitted to the Committee for approval at its next meeting.

**Availability of Documents, Minutes, and Correspondence**

- .14 Much of the Committee's work is devoted to subjects for which documents are prepared and made available to member firms and other interested parties. Such documents include standards for performing and reporting on reviews and interpretations thereof and guidelines and instructions for making such reviews.
- .15 The Section has been exempted from the AICPA's open meeting policy, and, therefore, information such as agendas, minutes, drafts of documents, and Committee correspondence will not be made available to the general public. However, all information concerning the activities of the Committee is made available to the Public Oversight Board and its staff.

**Meeting Sites**

- .16 The AICPA's policy on meeting sites is contained in a resolution on committee meeting locations adopted by the board of directors (Appendix, SECPS §6000.24).

**VOTING PROCEDURES**

**Standards and Interpretations of Standards**

- .17 The issuance of standards and interpretations of standards requires the written approval of ten Committee members. Members may elect to qualify their approval of a standard or interpretation or dissent to its adoption; however, neither the existence of a qualified assent or dissent nor the reasons therefor are published with the standard or interpretation. If the total of (1) the Committee members who dissent to publication of a final statement or interpretation and (2) the Committee members who qualify their approval of publication of a final statement or interpretation with respect to the same issue exceed nine, the document will not be approved.
- .18 The Committee considers the need to solicit views from member firms and interested parties on proposed standards and interpretations on a case-by-case basis. The written approval of ten Committee members is required to publish a discussion draft of a proposed standard or interpretation. Members may elect to dissent (but not qualify their assent) to the publication of a discussion draft; however, neither the existence of a dissent nor the reasons therefor will be published with the discussion draft.
- .19 Issuance of a statement or interpretation requires the written authorization of the Committee chairman, the chairman of the subcommittee or task force, if any, and the director of the SEC Practice Section. Such individuals are authorized to make editorial changes to drafts upon which members balloted, provided the substance of the statement or interpretation is not changed.

**Other Matters Requiring Committee Approval**

- .20 All other matters requiring approval of Committee members are adopted based on the affirmative votes of a majority of committee members (and, where applicable, their alternates) present and eligible to vote. Such votes may be taken by a show of hands, by written ballot, or by telephone poll conducted by the chairman or the staff, as determined by the chairman in each instance.

**Abstention From Committee Discussions and Voting**

- .21 A Committee member may not participate in the deliberations and is not eligible to vote on a matter that relates to the member's firm, or to a peer review performed by the member's



firm or in which he participated, or when he believes he may have a conflict of interest.

**CORRESPONDENCE**

- .22 The Committee relies heavily on correspondence for information about agenda items and other matters relating to its operations. Correspondence from other members of the Committee and its subcommittees and task forces is often used by members in reaching their decisions on proposals. Accordingly, all correspondence soliciting comments should be acknowledged by each member, even if such acknowledgement merely indicates that the member has no comments or suggestions on the proposal.
  
- .23 Copies of all correspondence should be sent to all individuals included on distribution lists prepared by the staff. All requests for comments should identify the distribution list that should be used. The distribution lists ordinarily include the members of the Committee, their alternates and advisors, selected members of the staff, selected members of the Public Oversight Board and its staff, and, as applicable, members of subcommittees and task forces. Individuals on a distribution list may ask to receive a reasonable number of extra copies of correspondence.

**6008 Peer Review Committee Meeting and Voting Procedures**

**.24 APPENDIX—Resolution on Location of AICPA Committee Meetings**

1. The board of directors has approved the following criteria to be used in the selection of sites for meetings of AICPA committees.
2. Except in unusual circumstances, the meetings should be held at sites that
  - a. Minimize the time and distance of travel of a majority of committee members and staff.
  - b. Are readily accessible by air transportation.
  - c. Are reasonably accessible from airports by public transportation.
  - d. Provide good accommodations at a reasonable cost.
  - e. Avoid surroundings that are likely to detract from the success of the meeting.
  - f. May coincide with the site of another meeting at which the majority of committee members will be in attendance.
  - g. Accommodate the needs of other groups with which the committee must meet to conduct its business.
3. Resort area sites may be utilized if they meet all of the above criteria.
4. The board of directors recognizes that it is not possible or even desirable to attempt to eliminate the application of judgment in selecting the location of committee meetings. However, if it appears necessary to depart from these guidelines, the decision to do so should be cleared with the president of the AICPA.

Section VII

QUALITY CONTROL INQUIRY COMMITTEE

TABLE OF CONTENTS

Section

7000	Objectives, Organization and Operations of the Quality Control Inquiry Committee
------	---



TABLE OF CONTENTS

<u>Section</u>		<u>Paragraph</u>
7000	Appendixes	
	A-Guidelines for Consideration of Non Reportable Matters Involving Regulated Financial Institutions . . . . .	.28
	B-Framework for the Evaluation Process of the SECPS Quality Control Inquiry Committee . . . . .	.29

## Objectives, Organization, and Operations of the Quality Control Inquiry Committee

### OBJECTIVES

- .01 The first objective of the SEC Practice Section is to "improve the quality of practice of CPA firms before the Securities and Exchange Commission through the establishment of practice requirements for member firms." Those practice requirements include adherence to quality control standards established by the AICPA and triennial peer review of the accounting and auditing practice of member firms. Peer reviewers evaluate the firm's quality control system and test compliance with that system by, among other things, reviewing the work performed on a sample of the firm's accounting and auditing engagements.
- .02 Deficiencies in the conduct of an audit or reporting thereon—commonly referred to as "audit failures"—are usually the result of isolated instances of misunderstanding of instructions, mistakes of judgment, carelessness, or other personal factors. Because the possibility of human error always exists, no system of quality control is a guarantee that there will be no audit failures—just as an audit itself, which is based on the concept of selective testing, is not a guarantee that material errors and irregularities will be detected. However, it is also true that some audit failures can indicate a weakness in a firm's quality control system or in its compliance with that system, and some can indicate the need for changes in generally accepted auditing standards or in quality control standards.
- .03 The courts and other judicial, regulatory, and governmental bodies have the means to determine whether allegations of audit failures are correct, and are empowered to punish firms and individuals when punishment is appropriate under the law. The SEC Practice Section was not established to duplicate those functions. However, the objectives of judicial or regulatory proceedings ordinarily do not include determining whether a firm should take corrective measures or whether changes in professional standards should be considered. There is a significant public interest in timely determinations of such matters, because they may have a bearing on the reliability of financial statements used by the public.

#### **7004 Objectives, Organization, and Operations of the Quality Control Inquiry Committee**

- .04 In recognition of that significant public interest, the Quality Control Inquiry Committee (the Committee)<sup>1</sup> was established by the Executive Committee of the SEC Practice Section in 1979 to make such investigation as it considers necessary to determine whether alleged audit failures indicate a possible need for corrective measures by the member firm involved or indicate that changes in generally accepted auditing standards or quality control standards need to be considered, and to recommend to the Executive Committee sanctions when deemed appropriate. In carrying out these responsibilities, the Committee is governed by the provisions herein.
- .05 The alleged audit failures that shall occasion an investigation of the type described herein are those that are required to be reported to the Committee pursuant to the membership requirement in SECPS §1000.08k. This reporting requirement has been constructed in the light of the Section's primary objective, which is to improve the quality of practice by CPA firms before the Securities and Exchange Commission.
- .06 The Committee may identify a significant public interest in an alleged audit failure that is not required to be reported to the Committee. The Executive Committee shall determine what actions, if any, shall be taken by the Section with respect to such matters. (See Appendix A, SECPS §7000.)
- .07 In carrying out its duties, the Committee shall give primary consideration to the significant interests of the public in the adequacy of generally accepted auditing standards and quality control standards and in compliance by member firms with those standards in the conduct of their accounting and auditing practice, and shall also seek to deal fairly with the legitimate interests of member firms. The Committee shall also take into consideration in deciding upon its course of action those substantial incentives that are already in place for a firm and individuals in such firm to adhere to professional standards in the performance of the audit function. These incentives include penalties and publicity resulting from court and SEC actions, availability to the public of

---

<sup>1</sup> On December 6, 1988, the Executive Committee changed the name from the Special Investigations Committee (SIC) to the Quality Control Inquiry Committee (the Committee).

**Objectives, Organization, and Operations of the Quality 7005  
Control Inquiry Committee**

information concerning corrective actions deemed necessary by the Peer Review Committee, which include accelerated peer reviews and disciplinary proceedings against individuals by the AICPA and state professional societies and boards. While carrying out its responsibilities, the Committee shall also recognize that substantial prejudice can accrue as a result of its investigative activities to a firm or individuals in that firm who are involved, or are about to be involved, in a court proceeding or a proceeding or investigation by the SEC, a grand jury, or other governmental body, and who are entitled to all of the protections afforded by law in such a proceeding or investigation.

- .08 During the course of its investigative procedures, the Committee may encounter situations indicating that pertinent guidance material on the application of generally accepted accounting principles could be enhanced. In such circumstances, the Committee should communicate its concerns to the Accounting Standards Executive Committee or other relevant AICPA technical body.

ORGANIZATION

- .09 The Committee structure and procedures shall be as follows:
- a. The Committee shall be composed of at least nine members who are partners or retired partners of member firms. Two Committee members associated with a member firm may serve on the Committee concurrently provided only one is active with that firm. Committee members shall be appointed by the Executive Committee, which shall also designate one member as the Chairman.
  - b. Each Committee member shall be initially appointed for a one-year term.
  - c. Members of the Committee shall be eligible for reappointment for additional one-year terms. Reappointment shall take into account the need for a balanced rotation of members.
  - d. A Committee member shall not serve concurrently as a member of either the Executive Committee or the Peer Review Committee of the Section.



**7006 Objectives, Organization, and Operations of the Quality  
Control Inquiry Committee**

- e. A majority of the Committee must be present to constitute a quorum. (With respect to a quorum for a hearing, see section 4.2c of the Sections's Rules of Procedure for the imposition of Sanctions.)
- f. A member of the Committee shall not take part in deliberations with respect to the member's firm or any other firm with respect to which the Committee or the member believes there is a conflict of interest. The Committee shall establish guidelines for determination of conflicts of interest for this purpose.
- g. Affirmative votes of a majority of the Committee members eligible to vote shall be required for action on all specific matters relating to member firms. If less than a majority of Committee members are eligible to vote on such a matter, the Executive Committee shall appoint an additional member(s) to the Committee, who shall be a partner or retired partner of a member firm that is not represented on the Committee, who shall not be concurrently a member of the Executive Committee or the Peer Review Committee, and whose responsibilities and authority shall be restricted to the matter involving the specific member firm. On matters not involving specific member firms, such as administrative and procedural matters, a majority of the Committee members present at a meeting and voting shall be required for action.
- h. The meetings and procedures of the Committee and any of its task forces and all related information available to the Committee and any of its task forces shall be treated as confidential, except as indicated in sections (i) and (j), below and except that the Executive Committee may authorize public disclosure of information with respect to any investigation or sanction.
- i. The Committee's files, its meetings, and all meetings held with member firms at its request shall be open at all times to members of the Public Oversight Board and its representatives on a confidential basis, except that, after giving the firm concerned an opportunity to present its views and after consultation with the Executive

**Objectives, Organization, and Operations of the Quality 7007  
Control Inquiry Committee**

Committee, the Public Oversight Board may make public disclosure of information thus obtained that it deems necessary in the interest of the public or the profession.

- j. When the Committee closes its files on a case, the Committee's staff prepares a closed case summary on the matter that, together with a checklist prepared by the staff of the Public Oversight Board, will be made available for reading by the staff of the Securities and Exchange Commission. Such closed case summaries are not to be retained for more than thirty days from the date that the SEC staff is notified the summaries are available for review.
- .10 The Committee may adopt operating guidelines or procedures that are consistent with the provisions herein, subject to the approval of the Executive Committee.
- .11 The Committee shall have whatever staff it needs to perform its functions.

OPERATIONS

Information to Be Reported to the Committee

- .12 SEC Practice Section member firms should report to the Committee the information specified in SECPS §1000.08k.
- .13 The term "case," as used hereinafter, refers to (a) an alleged audit failure in connection with litigation, proceedings, or investigations reported pursuant to the Section's membership requirement, (b) matters added through application of Appendix A, SECPS §7000.28, and (c) other matters added to the Committee's agenda at the request or with the approval of the Executive Committee.
- .14 The procedures for reporting cases by each firm shall be reviewed in the triennial peer reviews. Also, the Committee's staff shall review compliance with the reporting requirements by monitoring selected financial and business publications and published reports on activities of the Securities and Exchange Commission.

**7008 Objectives, Organization, and Operations of the Quality Control Inquiry Committee**

Coordination With the Professional Ethics Division

- .15 The Section's Executive Committee has approved a memorandum of understanding on cooperation and coordination between the AICPA Professional Ethics Division and the Quality Control Inquiry Committee. The provisions in that memorandum are intended to minimize duplication in the conduct of investigations while maintaining appropriate confidentiality with respect to information obtained. However, the responsibilities and authority of the two groups are not synonymous. In particular, only the AICPA Professional Ethics Division has jurisdiction over individual members of the AICPA with respect to the AICPA Code of Professional Conduct.

Investigative Procedures

- .16 To achieve the objectives set for it by the Executive Committee, the Committee or one or more of its members acting on its behalf shall perform the procedures authorized herein to the extent deemed necessary to determine whether the implications of a case indicate (a) that a special review of the firm is necessary or (b) that changes in generally accepted auditing standards or quality control standards should be considered.
- .17 The procedures performed by the Committee or on its behalf to achieve that objective are presented in Appendix B, SECPS §7000.29, "Framework for the Evaluation Process of the SECPS Quality Control Inquiry Committee."
- .18 In deciding on and carrying out the investigative procedures that are appropriate in the circumstances, the Committee shall be guided by the considerations in SECPS §7000.07.
- .19 A firm is required to cooperate with the Committee by furnishing on a timely basis, upon request, the information contemplated in Appendix B. SECPS §7000.29 and by authorizing its peer reviewers to comply with requests for such information. A firm is not required to provide the Committee or its representatives with information that would invade the attorney-client privilege, or with the litigation work product of the firm or any of its partners or employees.
- .20 The procedures described in Appendix B. SECPS §7000.29 shall be undertaken expeditiously.

**Objectives, Organization, and Operations of the Quality 7009  
Control Inquiry Committee**

- .21 A decision by the Committee to close its files on a case does not relieve a firm of its obligation to report additional proceedings, settlements, court decisions on substantive issues, and the filing of appeals within thirty days of their occurrence. Based on its evaluation of such reports, the Committee may decide to reopen its files on the case.
- .22 Before a motion to order a special review of a member firm is put to a vote, the firm shall be given the opportunity to attend a meeting of the Committee to hear the reasons offered in support of the motion, to present its views on the matter, and to respond to questions by members of the Committee. The firm shall be excused from the meeting before the Committee votes on the motion. Firms are required to comply with the Committee's decision on such a motion and are required to pay for the Section's out-of-pocket costs for the time and expenses of any paid reviewers.

Sanctions

- .23 If a firm refuses to cooperate in providing information to the Committee, refuses to undergo a special review ordered by the Committee or to pay for the cost of such a review, or refuses or otherwise fails to take the corrective actions deemed reasonable and necessary by the Committee, such refusal or failure shall constitute a basis on which the Committee may recommend to the Executive Committee that sanctions be imposed on the firm. Such sanctions shall be recommended only after findings have been made in a hearing held in accordance with the Section's Rules of Procedure for the Imposition of Sanctions. The types of sanctions that may be recommended are described in SECPS §1000.29.
- .24 The results of the Committee's procedures, including any special review ordered by the Committee, may reveal failures to comply with the Section's membership requirements for which corrective action alone would be an inadequate response. In these circumstances also, the Committee may recommend to the Executive Committee that sanctions be imposed on the firm. However, given the requirements of the Section for documented and communicated quality control policies and procedures, for triennial peer review, and for continuing professional education, such circumstances are expected to be encountered rarely, if at all.

**7010 Objectives, Organization, and Operations of the Quality  
Control Inquiry Committee**

- .25 A member firm's public file shall include a copy of documents setting forth sanctions approved by the Executive Committee. Such a decision, with the name of the member firm, shall be published in an AICPA membership periodical in a form considered appropriate by the Executive Committee.

Communications and Reports

- .26 The Committee shall submit periodic reports to the Executive Committee concerning cases on its agenda, in accordance with guidelines established by the Executive Committee.
- .27 The Committee shall promptly communicate with the AICPA Auditing Standards Board or Accounting Standards Executive Committee, as appropriate, when it believes there is a need to assess the adequacy of generally accepted auditing standards, quality control standards, or other relevant AICPA guidance material. Such communications shall be made without reference to specific cases on the Committee's agenda.

**Objectives, Organization, and Operations of the Quality 7011  
Control Inquiry Committee**

**.28 APPENDIX A--Guidelines for the Consideration of Non-Reportable  
Matters Involving Regulated Financial Institutions**

1. When the Quality Control Inquiry Committee (the "QCIC") learns that a federal or state governmental agency has filed a lawsuit against a member firm for an alleged audit failure involving the financial statements of a regulated financial institution (for example, a bank, savings and loan association, credit union, or insurance company) that is not "an SEC client" as defined in Appendix D, SECPS §1000.38 then the QCIC shall request the member firm to provide it with a copy of the complaint.
2. The QCIC shall screen the allegations in a complaint received under this policy. If the QCIC determines that the allegations indicate a possible need for corrective measures by the member firm, which have not previously been addressed by the QCIC, then the QCIC shall request the member firm to volunteer to place the case on the QCIC's case agenda.
3. If the member refuses to provide a complaint to the QCIC or declines to volunteer to place the case on the QCIC's agenda, then the QCIC shall request the Executive Committee to determine what action, if any, shall be taken by the Section.
4. In carrying out its procedures, the QCIC may consolidate cases involving a particular firm to avoid duplication of effort. (The Executive Committee will monitor the application of these guidelines and review the need for its continuation on a periodic basis.)

**7012 Objectives, Organization, and Operations of the Quality Control Inquiry Committee**

**.29 APPENDIX B—Framework for the Evaluation Process of the SECPS Quality Control Inquiry Committee**

1. This framework recognizes the importance of the Quality Control Inquiry Committee (the "QCIC") to the self-regulatory process and explicitly recognized that the QCIC may undertake a special review of a member firm in connection with any case reported to it unless circumstances or other procedures allow the QCIC to conclude that such a review is not necessary. This document also describes some of those circumstances and procedures. While it does not and cannot specify all possible criteria or circumstances that would obviate the performance of a special review, it does establish a structured framework for the QCIC's evaluation process. This approach relies heavily on the judgment of the QCIC in individual circumstances. Definitive criteria for determining an appropriate course of action are included in this framework, including when it is appropriate to undertake a special review of a member firm's quality control system.
2. The activities of the QCIC take place in four distinct phases. Each case added to the QCIC's agenda may require the QCIC to follow the procedures described herein that fall within any or all of the four phases, depending on the circumstances presented by the specific case. The procedures to be followed or considered in each of the phases and definitive guidelines for the QCIC or its task forces in making decisions regarding further investigation of the member firm's quality control system and compliance therewith follow.
3. Analysis of Allegations
  - a. Procedures - Read the complaint, relevant financial statements and any other publicly available, relevant materials.
  - b. Evaluation of Results and Appropriate Actions - Proceed to the general inquiries phase unless the case file can be closed because the complaint against the firm is considered, after QCIC analysis (including information about the entity or its industry), to be frivolous. A frivolous complaint is characterized by:
    1. Allegations that do not relate to a period in which

**Objectives, Organization, and Operations of the Quality 7013  
Control Inquiry Committee**

- the auditor was associated with the entity's financial statements; or
2. Allegations that are so general in nature that they do not raise serious implications concerning the adequacy of a firm's system of quality control, or its compliance with that system (for example, failed to exercise due professional care, failed to adhere to the principle of conservatism); or
  3. Allegations that attribute the results of one period to an earlier period or to an inappropriate action by management (for example, net income for the year ended XX/XX/XX was overstated) with no apparent evidence or substantiation; or
  4. Allegations that ignore relevant and adequate disclosures made in the financial statements or in a report or other document in which such financial statements appear, or ignore information contained in the auditor's report (for example, the report is qualified for going concern considerations); or
  5. Allegations that do not relate to matters that are encompassed by existing generally accepted accounting principles or generally accepted auditing standards, or that clearly misstate the requirements of such professional standards (for example, net income was falsely stated by the inclusion of an allowance for funds used during construction).
4. General Inquiries Concerning a Firm's Quality Control Policies and Procedures and Compliance Therewith
- a. Procedures to be Considered in Each Case and Followed As Deemed Appropriate by the QCIC - Discuss issues addressed by the allegations that have quality control implications with representatives of the firm and, if deemed appropriate, its peer reviewers, or examine peer review or internal inspection results.
  - b. Evaluation of Results and Appropriate Actions - Proceed to the in-depth inquiries phase unless the case file can



**7014 Objectives, Organization, and Operations of the Quality  
Control Inquiry Committee**

be closed because one or more of the following conditions exist:

1. The relevant aspects of the firm's system of quality control are considered adequate based upon the QCIC's review of relevant and recent peer review or internal inspection results covering the specific office and personnel.
  2. Allegations that are so general in nature that they do not raise serious implications concerning the adequacy of a firm's system of quality control, or its compliance with that system (for example, failed to exercise due professional care, failed to adhere to the principle of conservatism); or
  3. Allegations that attribute the results of one period to an earlier period or to an inappropriate action by management (for example, net income for the year ended XX/XX/XX was overstated) with no apparent evidence or substantiation; or
  4. Allegations that ignore relevant and adequate disclosures made in the financial statements or in a report or other document in which such financial statements appear, or ignore information contained in the auditor's report (for example, the report is qualified for going concern considerations): or
  5. Allegations that do not relate to matters that are encompassed by existing generally accepted accounting principles or generally accepted auditing standards, or that clearly misstate the requirements of such professional standards (for example, net income was falsely stated by the inclusion of an allowance for funds used during construction).
4. General Inquiries Concerning a Firms Quality Control Policies and Procedures and Compliance Therewith
- a. Procedures to be Considered in Each Case and Followed As Deemed Appropriate by the QCIC - Discuss issues addressed by the quality control implications with representatives of the firm and, if deemed appropriate, its peer

**Objectives, Organization, and Operations of the Quality 7015  
Control Inquiry Committee**

reviewers, or examine peer review or internal inspection results.

b. Evaluation of Results and Appropriate Actions - Proceed to the in-depth inquiries unless the case file can be closed because one or more of the following conditions exist:

1. The relevant aspects of the firm's system of quality control are considered adequate based upon the QCIC's review of relevant and recent peer review or internal inspection results covering the specific office and personnel.
2. A peer review or internal inspection will satisfactorily address on a timely basis the relevant aspects of the firm's practice or system of quality control (including the office and engagement personnel) and its findings will be reported to the QCIC.
3. The firm provides the QCIC with information that satisfactorily demonstrates that the allegations do not present quality control implications that have not been adequately addressed internally or that require direct testing. Such information would necessarily be determined by the circumstances of the particular case and could involve meeting with representatives of the firm to discuss the allegations and their relationship to established firm auditing or quality control policies and procedures or a review of firm guidance materials or personnel assignments. The information might, for example, provide the QCIC with a reasonable basis to conclude that:
  - a. The firm's quality control policies are adequate and were complied with in the performance of the engagement in litigation; or
  - b. The complaint stems from a business failure, not an audit failure; or

**7016 Objectives, Organization, and Operations of the Quality  
Control Inquiry Committee**

- c. Nothing more than minor changes in quality control were necessary, and the firm has taken appropriate corrective measures and has satisfied the QCIC that those changes are effective.
5. In-Depth Inquiries Concerning a Firm's Quality Control Policies and Procedures and Compliance Therewith
- a. Procedures to be Considered in Each Case and Followed As Deemed Appropriate by the QCIC - Discuss quality control policies and procedures and compliance therewith with firm personnel who are or have become familiar with the subject engagement; review firm technical manuals, guidance materials, and recent inspection reports; or read certain audit documentation having a bearing upon the member firm's awareness and consideration of the issues addressed by allegations made against the firm.
  - b. Evaluation of Results and Appropriate Actions - Proceed to special review phase unless the case file can be closed because one or more of the following conditions exist:
    1. Responses to QCIC inquiries provide a reasonable basis to conclude that the firm's quality control policies and procedures are adequate and were complied with in the perform of the engagement in litigation; or
    2. It is reasonable to conclude that the complaint stems from a business failure, not an audit failure; or
    3. Nothing more than minor changes in quality control were necessary, and the firm has taken appropriate corrective measures and has satisfied the QCIC that those changes are effective; or
    4. A peer review or internal inspection will satisfactorily address on a timely basis the relevant aspects of the firm's practice or quality control (including the office and management personnel) and its findings will be reported to the

**Objectives, Organization, and Operations of the Quality 7017  
Control Inquiry Committee**

QCIC.

**6. Special Review**

- a. A special review is usually ordered whenever the QCIC, on the basis of its evaluation of responses to in-depth inquiries regarding a firm's quality control policies and procedures and the firm's compliance therewith, is not satisfied as to whether a firm's quality control system provides the firm with reasonable assurance of performing audit engagements in compliance with professional standards, whether for the firm as a whole, an office, or a specific industry.
  
- b. The scope of a special review is directly related to the extent of the possible quality control deficiency and the determination of any corrective action that may be needed. All or part of a firm's system may be reviewed as illustrated by these five types of review.
  1. Review of other engagements supervised by personnel who supervised the allegedly faulty audit when additional assurance is required concerning their ongoing compliance with the firm's quality control policies and procedures. To the extent possible, emphasis is to be placed on engagements with attributes similar to those of the allegedly faulty audit.
  2. Review of selected engagements in the same industry— on an office or firm-wide basis— to ascertain the adequacy of industry expertise.
  3. Review of an office or offices to ascertain compliance with the firm's quality control policies and procedures.
  4. Review of selected engagements with unique transactions or conditions to evaluate the quality of the firm's accounting and auditing guidance, the quality of its consultation, or its approach to auditing enterprises in a specialized industry.
  5. Review of the entire system (for example, an

**7018 Objectives, Organization, and Operations of the Quality  
Control Inquiry Committee**

accelerated review).

- c. In determining the emphasis to be placed on reviewing other work performed by personnel responsible for the alleged audit failure, the QCIC shall place primary reliance on the results of its in-depth inquiry procedures. Additional work performed by the responsible personnel shall be reviewed when the results of those procedures indicate that the alleged audit failure, if there was one, resulted from inadequate compliance with the member firm's quality control policies and procedures. The scope of additional work to be reviewed shall be determined based on the circumstances and the QCIC's judgment, but shall generally include several additional engagements.
  
- d. A special review can be performed independently, in conjunction with a regularly scheduled peer review, or in conjunction with an internal review performed as a part of the firm's formal inspection program. In each case, the QCIC must approve the scope of the review and require that the results of the review be reported independently to the QCIC. The QCIC will determine the extent of supervision it will exercise regarding the conduct of such review. In this context, the QCIC will place greater reliance on, and require less direct supervision of, a peer review than an internal review conducted by the member firm.

**Section VIII**

**CONTINUING PROFESSIONAL EDUCATION**

**TABLE OF CONTENTS**

**Section**

**8000            Continuing Professional Education Requirements**

## SECPS Section 8000

## CONTINUING PROFESSIONAL EDUCATION REQUIREMENTS

## TABLE OF CONTENTS

<u>Section</u>	<u>Paragraph</u>
8000 Continuing Professional Education Requirements	
Basic Requirement . . . . .	.01 - .07
Effective Date and Transition . . . . .	.08 - .10
Qualifying Programs . . . . .	.11 - .18
Requirements for Formal Continuing Professional Education Program Measurement . . . . .	.19 - .27
Requirements for Formal Continuing Professional Education Program Reporting . . . . .	.28 - .32
Requirements for Formal Continuing Professional Education Program Development and Presentation . . . . .	.33 - .49
Development . . . . .	.35 - .39
Presentation . . . . .	.40 - .49

**Continuing Professional Education Requirements****BASIC REQUIREMENT**

- .01 The fundamental purpose of continuing professional education (CPE) is to help professionals in member firms maintain and/or increase their professional competence. A professional's field of employment does not limit the need for continuing professional education. Therefore, this requirement applies to all professionals in member firms, including CPAs and non-CPAs, who reside in the United States. All such professionals are required to participate in at least 20 hours of qualifying continuing professional education every year and in at least 120 hours every three years. Effective for CPE years beginning on or after January 1, 1995, professionals who devote at least 25% of their time to performing audit, review or other attest engagements (excluding compilations), or who have the partner/manager-level responsibility for the overall supervision or review of any such engagements, must obtain at least 40% (eight hours in any one year and 48 hours every three years) of their required CPE in subjects relating to accounting and auditing. The term *accounting and auditing subjects* should be broadly interpreted, and for example, include subjects relating to the business or economic environments of the entities to which the professional is assigned. Exceptions to this requirement are set forth in SECPS §8000.05-.06 and .08-.10. Compliance with this requirement will be determined annually for the three most recent educational years. Professionals are expected to maintain the high standards of the profession by selecting quality education programs to fulfill their continuing education requirements.
- .02 Persons classified as "professional staff" (including partners) in a member firm's annual report to the SEC Practice Section (SECPS) shall be considered "professional" for purposes of these continuing professional education policies. (See SECPS §1000.08g.(7))
- .03 Each member firm may select any year-long period (educational year) for applying these continuing professional education policies. The educational year may differ from the member firm's fiscal year; however, both periods are to be specified in the annual report filed with



**8004 Continuing Professional Education Requirements**

the SECPS.<sup>1</sup> (See SECPS §1000.08g.) A change in a member firm's educational year shall be stated in the firm's annual report for the year in which the change is made.

- .04 It is the responsibility of each member firm to ensure that all professionals comply with these continuing professional education requirements. A professional may have to meet continuing professional education requirements of a state licensing body, other governmental entities, a membership association, or other organizations or bodies. If compliance with the mandatory continuing professional education requirements of these bodies is used as a basis for compliance with the SECPS requirements, it is the responsibility of the member firm to ensure that these requirements are met.
- .05 Exceptions to the SECPS continuing professional education requirements can be made for reasons of health, military service, foreign residency, retirement, or other good reason if such reason prohibits compliance with the requirements. A firm should be prepared to justify any exceptions made.
- .06 The following SECPS requirements apply to those professionals who were not employed by the member firm during the entire most recent three educational years:
  - a. Professionals who were not employed during the entire most recent educational year are not required to have participated in any continuing professional education.
  - b. Professionals who were employed during the entire most recent educational year, but not during the entire most recent two educational years, are required to have participated in at least 20 hours of qualifying continuing

---

<sup>1</sup> When mandatory continuing professional education requirements for state licensing or for state society membership provide that the period to be used for determining compliance with those requirements shall vary by individuals (for example, the period might coincide with the date of the individual's license to practice), such periods may be used for determining whether there was compliance with the SECPS's continuing professional education requirements during the firm's educational year.

Additionally, firms with offices in more than one state that are required to employ different periods in each state for maintaining compliance with continuing professional education requirements are deemed to be in compliance with the SECPS's requirements.

professional education during the most recent educational year.

- c. Professionals who were employed during the entire most recent two educational years, but not during the entire most recent three educational years, are required to have participated in at least 20 hours of qualifying continuing professional education during each of the two most recent educational years.<sup>2</sup>
- .07 Any professional who has not participated in the required number of continuing professional education hours during any education year shall have the two months immediately following that period to make up the deficiency. Any continuing professional education hours claimed during the two-month period to make up a deficiency may not also be counted toward the 20-hour requirement of the educational year in which they are taken. Further, any continuing professional education hours claimed during the two-month period to make up any deficiency for the preceding three educational years may not also be counted toward the 120-hour requirement of any three-educational-year period that does not include at least one year of the three-educational-year period for which the deficiency was made up.

#### EFFECTIVE DATE AND TRANSITION

- .08 Except as stated below, a member firm shall be subject to these policies as of the beginning of its first full educational year. For each member firm, this educational year shall begin during the first twelve months after it becomes a member of the SECPS. For example, if a firm joins the SECPS on January 1992 and elects an educational year ending in June that firm must be in compliance with the continuing professional education requirements of the SECPS for its educational year ended June 1993.
- .09 During a member firm's first two educational years, all professionals must participate in at least 20 hours of continuing professional education each year, except as provided in SECPS §8000.06.

---

<sup>2</sup> Member firms have a responsibility to adopt policies and procedures that provide reasonable assurance that all professional personnel are properly trained. The nature and extent of training needed by part-time personnel depend on a number of factors, including the type of work they perform, the degree of supervision they receive, and the number of hours they work. A firm should be prepared to justify any decision not to require a part-time professional to participate in the required number of continuing professional education hours.

**8006 Continuing Professional Education Requirements**

- .10 During a member firm's first five educational years, it need only maintain or retain the continuing professional education records, data, or evidence of attendance or completion referred to in SECPS §8000.28-.32 since the beginning of the member firm's first educational year.

**QUALIFYING PROGRAMS**

- .11 A person performing services of a professional nature needs to have a broad range of knowledge, skills, and abilities. Thus, the concept of professional competence should be interpreted broadly. Accordingly, programs contributing to the development and maintenance of nontechnical professional skills should also be recognized as acceptable continuing education.
- .12 Acceptable subjects include the fields of study set forth in the AICPA National CPE Curriculum: accounting and auditing, advisory services, specialized knowledge and applications, management, personal development, and taxation. Other subjects may also be acceptable if they maintain and/or increase the professional's competence.
- .13 While professionals participate in a wide variety of learning activities, continuing professional education credit is allowed only for formal programs of learning that maintain or increase the professional competence of the individual. A formal program of learning is a process that is designed and intended primarily as an educational activity and complies with the requirements of the SECPS. All other competence-building and learning activities are considered to be informal. Even though no credit is allowed for informal learning activities, these learning activities are very important in attaining and maintaining professional competence, and they are a regular part of a professional's continuing development.
- .14 Attendance at the following group programs will qualify only if the program is designed and intended primarily as an educational activity and complies with the continuing professional education requirements of the SECPS:
- a. Professional education and development programs of national, state and local accounting organizations
  - b. Technical sessions at meetings of national, state and local accounting organizations and their chapters
  - c. University or college courses (both credit and non-credit)
  - d. In-firm education programs

- e. Programs of other organizations (accounting, industrial, professional, etc.)
  - f. Professional society and committee meetings
  - g. Dinner, luncheon and breakfast meetings
  - h. Firm meetings for staff and/or management groups
- .15 Portions of the foregoing meetings devoted to administrative and firm matters often do not qualify for continuing professional education credit. For example, portions devoted to the communication and application of a professional policy or procedure may qualify. However, portions devoted to member firm's financial and operating matters generally would not qualify.
- .16 The following also qualify for continuing professional education credit:
- a. Self-study programs (interactive and non-interactive) that comply with the requirements of the SECPS
  - b. Service as an instructor or discussion leader at a continuing professional education program (both preparation and presentation time) if the program increases professional competence and qualifies for credit for participants
  - c. Publication of articles, books or continuing professional education programs
- .17 An interactive self-study program is a program designed to use interactive learning methodologies that simulate a classroom learning process by employing software, other courseware or administrative systems that provide significant ongoing, interactive feedback to the learner regarding his or her learning progress. Evidence of satisfactory completion of each program segment by the learner is often built into such programs. These programs clearly define lesson objectives and manage the student through the learning process by (1) requiring frequent student response to questions that test for understanding of the material presented, (2) providing evaluative feedback to incorrectly answered questions, and (3) providing reinforcement feedback to correctly answered questions. Therefore, capabilities are used that, based on student response, provide appropriate ongoing feedback to the student regarding his or her learning progress through the program.

**8008 Continuing Professional Education Requirements**

.18 A non-interactive self-study program is any self-study program that does not meet the above criteria for interactive self-study programs.

**REQUIREMENTS FOR FORMAL CONTINUING PROFESSIONAL EDUCATION PROGRAM MEASUREMENT**

.19 All programs should be measured in 50-minute contact hours. The shortest program for credit should consist of one contact hour. The purpose of this standard is to develop uniformity in the measurement of formal programs. A contact hour is 50 minutes of participation in a group program. Under this standard, credit is granted only for full contact hours. For example, a group program lasting 100 minutes would count for two contact hours; however, one lasting between 50 and 100 minutes would count for one contact hour. For programs in which individual segments are less than 50 minutes, the sum of the segments should be considered one total program. For example, five 30-minute presentations would equal 150 minutes and should be counted as three contact hours.

.20 Sponsors are encouraged to monitor group programs in order to accurately record the appropriate number of contact hours for participants who arrive late or leave before a program is completed.

.21 Self-study programs should be pre-tested to determine the average completion time. Interactive self-study programs should receive credit equal to the average completion time. Non-interactive self-study programs should receive credit equal to one-half of the average completion time. For example, an interactive self-study program that takes an average of 800 minutes to complete should be recommended for 16 contact hours of credit. A non-interactive self-study program that takes an average of 800 minutes to complete should be recommended for eight contact hours of credit. Developers should keep appropriate records of how the average completion time was determined.

.22 For university or college courses that meet the continuing professional education requirements, each unit of credit shall equal the following contact hours:

- a. Semester System                      15 hours
- b. Quarter System                        10 hours

.23 Contact hours for non-credit university or college courses shall be based on actual time spent in class.

- .24 Instructors or discussion leaders should be given credit for their preparation and presentation time if the programs increase their professional competence and qualify for credit for participants. Credit for instructors or discussion leaders should be measured in contact hours.
- .25 Instructors and discussion leaders should receive credit for both preparation and presentation. The first time they present a program, they should receive credit for actual preparation hours up to two times the number of presentation hours. For example, if a program is presented for eight contact hours, the instructors could receive up to 24 contact hours of credit (16 contact hours for preparation and eight contact hours for presentation). For repeat presentations, instructors should receive no credit unless they can demonstrate that the program content involved was substantially changed, and such change required significant additional study or research.
- .26 The maximum credit for preparation and presentation should not exceed 50 percent of the total credit required in a reporting period. For example, if an instructor's requirement is 120 contact hours during a three year educational period, the maximum credit that could be applied to meet the requirements of the SECPS would be 60 contact hours, even if 24 contact hours of presentation and up to 48 contact hours of preparation were earned during that period.
- .27 Writers of published articles, books, or continuing professional education programs should be given credit for their research and writing time if this time increases their professional competence. Credit for writers should be measured in contact hours. Writing articles, books, or education programs for publication is a structured activity that involves a formal process of learning. For the writer to receive credit, the article, book, or program must be formally reviewed and published by a publisher not under the control of the writer. Credit from this activity should be limited to 30 contact hours during any three year educational period.

**REQUIREMENTS FOR FORMAL CONTINUING PROFESSIONAL EDUCATION PROGRAM REPORTING**

- .28 Except as provided in SECPS §8000.08-.10, each member firm must maintain appropriate records for each professional for its most recent five educational years. These records should contain the following information for each continuing professional education activity for which credit is claimed for the individual:

a. Sponsoring organization

**8010 Continuing Professional Education Requirements**

- b.* Title of program and description of content
- c.* Date(s) attended or completed
- d.* Location of program (city/state)
- e.* Number of continuing professional education contact hours
- f.* Appropriate evidence of completion

**.29 Acceptable evidence of completion includes:**

- a.* For group programs, a certificate or other verification supplied by the sponsor
- b.* For a university or college course that is successfully completed for credit, a record of the grade the person received; for a non-credit course, a record of attendance and completion
- c.* For self-study programs, a certificate supplied by the sponsor after satisfactory completion of a workbook or examination
- d.* For instruction credit, evidence obtained from the sponsor of having been the instructor or discussion leader at a program
- e.* For published articles, books, or continuing professional education programs, evidence of publication

**.30 Except as provided in SECPS §8000.08-.10, each member firm must retain for at least five educational years the following information for programs it sponsors:**

- a.* Record of participation
- b.* Copy of the program materials
- c.* Date(s)
- d.* Location(s) of the program (city/state)
- e.* Instructor(s)
- f.* Number of contact hours
- g.* Summary of program evaluations

h. Evidence of compliance with responsibilities set out under these requirements

- .31 The appropriate amount of time for retention of this information is not dependent solely on the location of the program or sponsor. Therefore, sponsors should retain this information for a period of five years from the date the program is completed.
- .32 Sponsors may wish to provide a certificate or other verification to participants; in any event, sponsors should be prepared to furnish, upon request, a record of participation to participants. The record should reflect the credit hours earned by each participant, including those who arrived late or left early.

**REQUIREMENTS FOR FORMAL CONTINUING PROFESSIONAL EDUCATION PROGRAM DEVELOPMENT AND PRESENTATION**

- .33 Continuing professional education sponsors have a responsibility to comply with all applicable continuing professional education requirements. Sound administration, adequate resources, competent supervision and an effective and supportive organizational structure are necessary elements in the design, development, implementation and monitoring of continuing professional education programs. For each program sponsor, there should be an identifiable administrator charged with demonstrating compliance with these requirements.
- .34 When a sponsor works with others to develop, distribute, and/or present continuing professional education programs, the responsibility for ensuring that all requirements are met rests with the sponsor. The functions of each party should be identified and documented.

**Development**

- .35 Program developers should state learning objectives and specify the level of knowledge of the program. Learning objectives should specify what participants will be able to perform upon completing a program. A program may have more than one objective, but each objective should be written to be consistent with the program's specified level of knowledge. Levels of knowledge could be described as:
  - a. Basic — Covers fundamental principles and skills. This level is for individuals with limited or no exposure to the subject(s).
  - b. Intermediate — Builds on the basic level or upon fundamental principles and skills and focuses on their ap-



**8012 Continuing Professional Education Requirements**

plication. The level is for individuals with some exposure to the subject(s).

- c. Advanced — Focuses on the development of in-depth knowledge, a variety of skills and/or a broader range of application. This level is for individuals with significant exposure to the subject(s).
- d. Update — Provides a general overview of new developments. It is for individuals with a background in the subject(s) who wish to be kept up-to-date.

- .36 Program developers should state the prerequisites for education, experience or both for all programs. Prerequisites should be written in precise language so that potential participants can readily ascertain whether they qualify for the program or whether the program's specified level of knowledge is appropriate for them.
- .37 Program developers should be qualified in the subject matter and be knowledgeable in instructional design. Qualification in subject matter and a knowledge of instructional design may be obtained through appropriate practical experience or education or both. The level of technical competence and instructional design skills that the developer(s) should possess will vary depending on certain characteristics of the program, such as the number of times it will be presented, the length of the program, the complexity of the subject matter and the number of participants.
- .38 Program materials should be technically accurate, current, and sufficient to meet the program's learning objectives and should be reviewed periodically to ensure compliance with this requirement.
- .39 Program materials should be reviewed, to the extent necessary, before the materials are used, by a qualified person or persons other than the person(s) who developed them, in order to assure the program's technical accuracy, currency and sufficiency to achieve the learning objectives. In order to meet this standard, the program materials must be prepared in advance of presentation. The nature and extent of review will vary depending on the characteristics of programs. If a review is considered appropriate, the level of technical competence and instructional design knowledge of a reviewer should be at least equal to those of the program developer(s).

**Presentation**

- .40 Program sponsors should inform participants in advance of learning objectives, prerequisites, level of knowledge of the

program, program content, nature and extent of advance preparation, teaching method(s) to be used, recommended continuing professional education credit and relevant administrative policies.

- .41 In order for potential participants to effectively plan their continuing professional education, the significant features of the program should be disclosed in advance in brochures or other announcements. When programs are offered in conjunction with non-educational activities, or when several programs are offered concurrently, an appropriate schedule of events indicating those components that are recommended for continuing professional education credit should be made available to participants. The sponsor's registration policies and procedures should be formalized, published and made available to participants.
- .42 Program sponsors should encourage participation only by individuals with appropriate education, experience or both. Sponsors should comply with the spirit of this standard by encouraging:
  - a. Enrollment only by eligible participants
  - b. Timely distribution of materials
  - c. Completion of any advance preparation by participants
- .43 Program sponsors should select instructors qualified with respect to both program content and teaching methods used. The instructor is a key ingredient in the learning process in any group program. Therefore, it is imperative that sponsors exercise great care in selecting qualified instructors for all group programs. Qualified instructors are those who are capable, through background, training, education and/or experience, of communicating effectively and providing an environment conducive to learning. They should be competent in the subject matter, skilled in the use of the appropriate teaching method(s) and prepared in advance. Instructors are responsible for informing participants of any changes necessary to make the program current.
- .44 Sponsors should evaluate instructors' performance at the conclusion of each program to determine their suitability to continue to serve as instructors.
- .45 Program sponsors should ensure that the number of participants and physical facilities are appropriate for the teaching method(s) specified by the developer. The number of participants, quality of facilities, and seating arrangements are integral

**8014 Continuing Professional Education Requirements**

aspects of the educational environment and should be carefully controlled.

- .46 Program sponsors should provide an effective means for evaluating the quality of the program. The objective of evaluations is to increase program effectiveness. Evaluations should be solicited from both participants and instructors.
- .47 At a minimum, programs should be evaluated to determine whether:
  - a. Learning objectives have been met
  - b. Prerequisites were necessary or desirable
  - c. Program materials contributed to the achievement of the learning objectives
  - d. The program content was timely and relevant
- .48 In addition, group programs should be evaluated to determine whether:
  - a. The instructor's knowledge and presentation skills were effective
  - b. Facilities were satisfactory
- .49 Evaluations might include questionnaires completed after a program, oral feedback from participants or tests for the effectiveness of a program. Sponsors should periodically review the evaluation process to ensure its effectiveness.

**Section IX**

**PROFESSIONAL ISSUES TASK FORCE**

**TABLE OF CONTENTS**

**Section**

9000 Objectives, Organization, and Operations of the  
Professional Issues Task Force

## SECPS Section 9000

OBJECTIVES, ORGANIZATION, AND OPERATIONS OF THE PROFESSIONAL ISSUES  
TASK FORCE

## NOTICE TO READERS

This section, entitled "Objectives, Organization, and Operations of the Professional Issues Task Force," was approved by the Executive Committee of the SEC Practice Section of the AICPA Division for CPA Firms on January 20, 1994.

## TABLE OF CONTENTS

<u>Section</u>	<u>Paragraph</u>
9000 Objectives, Organization, and Operations of the Professional Issues Task Force	
Introduction . . . . .	.01
Objectives . . . . .	.02
Organization . . . . .	.03-.04
Operations . . . . .	.05-.06
The Process of Developing Practice Alerts .	.06

## Objectives, Organization, and Operations of the Professional Issues Task Force

### INTRODUCTION

- .01 The Professional Issues Task Force ("PITF") was created by the SEC Practice Section Executive Committee to accumulate and consider practice issues that appear to present audit concerns for practitioners and to disseminate information as appropriate.

### OBJECTIVES

- .02 The PITF is responsible for accumulating information on practice issues that present potential audit concerns for practitioners. It considers the need to develop and disseminate relevant information to the profession. The task force refers matters that may require a reconsideration or reinterpretation of existing standards to appropriate standard setting bodies.

### ORGANIZATION

- .03 The PITF consists of representatives from a number of committees and other bodies whose efforts deal with the quality of professional practice including: the SECPS Executive Committee; the SECPS Quality Control Inquiry Committee; the SECPS Peer Review Committee; the PCPS Executive Committee; the Auditing Standards Board; the AICPA Professional Ethics Executive Committee; and the legal or related departments of accounting firms.
- .04 The members, currently all from SECPS member firms, are selected by and serve at the discretion of the SECPS Executive Committee. The PITF is supported by the staff of the SEC Practice Section and the AICPA Auditing Standards Division.

### OPERATIONS

The PITF shall:

- .05 a. Be responsible for accumulating information on practice issues from the following sources:
1. Litigation considered by the SECPS quality control inquiry committee;
  2. The SECPS and AICPA peer review programs;
  3. The Public Oversight Board;

9004 Objectives, Organization, and Operations of the Professional Issues Task Force

4. Internal inspections conducted by SECPS and PCPS member firms;
  5. The SECPS executive committee;
  6. The professional ethics executive committee; and
  7. Matters identified by SECPS and PCPS member firms and other AICPA committees.
- b. Consider the information obtained from the above sources and develop practice alerts, as appropriate, for practitioners based on existing audit literature, the professional experience of task force members and information provided by SECPS member firms to their own professional staff.
- c. Publish practice alerts as information in retrievable form, supplemented by columns appearing in The CPA Letter and/or The Journal of Accountancy.

The information published by the PITF shall advise potential users the views expressed by the task force are not official opinions of the AICPA or any of its committees and the information provided is intended to assist practitioners in meeting their professional responsibilities.

The Process of Developing Practice Alerts

- .06 The PITF selects topics for its non-authoritative Practice Alerts ("Alerts") based on information obtained from sources identified in SECPS §9000.05(a). Alerts are developed on selected subjects based on PITF consideration of existing literature, information provided by task force members and any internal information furnished by SECPS member firms. Proposed Alerts are written by AICPA staff and considered by the PITF. Alerts receive final consideration and are approved by the Chair of the SECPS executive committee.

SECPS

APPENDIXES

## TABLE OF CONTENTS

<u>Appendix</u>	<u>Page</u>
A-Statement on Quality Control Standards 2 and 4, <u>System of Quality Control for a CPA Firm's Accounting and Auditing Practice</u> .....	10,003
B-Statement on Quality Control Standards 3, <u>Monitoring a CPA Firm's Accounting and Auditing Practice</u> .....	10,015
C-Statement on Quality Control Standards 5, <u>The Personnel Management Element of a Firm's System Of Quality Control - Competencies Required by a Practitioner-in-Charge of an Attest Engagement</u> ....	10,023
D- <u>Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice</u> .....	10,031



## APPENDIX A

**Statement on Quality Control Standards 2 and 4**

Issued by the Auditing Standards Board  
May 1996, Amended January 2000

*System of Quality Control for a CPA Firm's Accounting and Auditing Practice*

Supersedes Statement on Quality Control Standards No. 1 and Its Interpretations, AICPA, *Professional Standards*, vol. 2, QC secs. 10 and 10-1.

Effective date: Applicable to a CPA firm's system of quality control for its accounting and auditing practice as of January 1, 1997.

The amendment to paragraph 18 promulgated by Statement on Quality Standards No. 4, is applicable to a CPA firm's system of quality control for its accounting, auditing, and attestation practice as of January 1, 2000.

Statements on Quality Control Standards are issued by the Auditing Standards Board. Firms that are enrolled in an Institute-approved practice-monitoring program are obligated to adhere to Quality Control Standards established by the Institute.

**Introduction and Applicability**

- .01 This section provides that a CPA firm shall have a system of quality control for its accounting and auditing practice and describes elements of quality control and other matters essential to the effective design, implementation, and maintenance of the system.
- .02 The AICPA Principles of Professional Conduct provide, among other things, that "members should practice in firms that have in place internal quality-control procedures to ensure that services are competently delivered and adequately supervised."<sup>1</sup> Because of the public interest in the services provided by and the reliance placed on the objectivity and integrity of CPAs, this section provides that a CPA firm shall have a system of

---

<sup>1</sup> AICPA Code of Professional Conduct, "Article VI—Scope and Nature of Services" (AICPA, *Professional Standards*, vol. 2, ET sec. 57.03)

10004 Statement on Quality Control Standards 2 and 4

quality control for its accounting and auditing practice.<sup>2</sup>

**System of Quality Control**

- .03 A firm<sup>3</sup> has a responsibility to ensure its personnel<sup>4</sup> comply with professional standards applicable to its accounting and auditing practice. A *system of quality control* is broadly defined as a process to provide the firm with reasonable assurance that its personnel comply with applicable professional standards and the firm's standards of quality. The policies and procedures designed to implement the system in one segment of a firm's practice may be the same as, different from, or interrelated with the policies and procedures designed for another segment, but the purpose of the system is the same for all segments of a firm's practice.
- .04 A firm's system of quality control encompasses the firm's organizational structure and the policies adopted and procedures established to provide the firm with reasonable assurance of complying with professional standards. 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 authority allowed its personnel and its offices, the knowledge and experience of its

---

<sup>2</sup> *Accounting and auditing practice* refers to all audit, attest, accounting and review, and other services for which standards have been established by the AICPA Auditing Standards Board or the AICPA Accounting and Review Services Committee under rule 201 or 202 of the AICPA Code of Professional Conduct (AICPA, *Professional Standards*, vol. 2, ET sections 201 and 202). Standards may also be established by other AICPA senior technical committees; engagements that are performed in accordance with those standards are not encompassed in the definition of an accounting and auditing practice.

<sup>3</sup> A *firm* is defined in the AICPA Code of Professional Conduct as "a form of organization permitted by state law or regulation whose characteristics conform to resolutions of Council that is engaged in the practice of public accounting, including the individual owners thereof" (AICPA, *Professional Standards*, vol. 2, ET section 92.05).

<sup>4</sup> The term *personnel* refers to all individuals who perform professional services for which the firm is responsible, whether or not they are CPAs.

personnel, the nature and complexity of the firm's practice, and appropriate cost-benefit considerations.

- .05 Any system of quality control has inherent limitations that can reduce its effectiveness. Variance in an individual's performance and understanding of (a) professional requirements or (b) the firm's quality control policies and procedures affects the degree of compliance with a firm's prescribed quality control policies and procedures and, therefore, the effectiveness of the system.
- .06 The system of quality control should provide the firm with reasonable assurance that the segments of the firm's engagements performed by its foreign offices or by its domestic or foreign affiliates or correspondents are performed in accordance with professional standards in the United States when such standards are applicable.

#### Quality Control Policies and Procedures

##### Elements of Quality Control

- .07 The quality control policies and procedures applicable to a firm's accounting and auditing practice should encompass the following elements:
  - a. *Independence, Integrity, and Objectivity*
  - b. *Personnel Management*
  - c. *Acceptance and Continuance of Clients and Engagements*
  - d. *Engagement Performance*
  - e. *Monitoring*
- .08 The elements of quality control are interrelated. For example, the maintenance of *Integrity, Objectivity*, and, where required, *Independence* requires a continuing assessment of client relationships. Similarly, the element of *Personnel Management* encompasses criteria for professional development, hiring, advancement, and assignment of the firm's personnel to engagements, which affect policies and procedures developed to meet the objectives of the quality control element of *Engagement Performance*. Similarly, policies and procedures for the quality control element of *Monitoring* are established to provide the firm with reasonable assurance that the policies and procedures related to each of the other elements of quality control are suitably designed and are being

effectively applied.

**Independence, Integrity, and Objectivity**

- .09 Policies and procedures should be established to provide the firm with reasonable assurance that personnel maintain independence (in fact and in appearance) in all required circumstances<sup>5</sup>, perform all professional responsibilities with integrity, and maintain objectivity in discharging professional responsibilities.
- .10 *Independence, Integrity, and Objectivity* are defined and more fully described in the AICPA Code of Professional Conduct (the Code) and AICPA, *Professional Standards*, vol. 1, AU sec. 220. Rules 101 and 102 of the Code, and the related Interpretations and Rulings (AICPA, *Professional Standards*, vol. 2, ET secs. 101, 102, and 191) contain examples of instances wherein a member's independence, integrity, and objectivity will be considered to be impaired. *Independence* encompasses an impartiality that recognizes an obligation for fairness not only to management and owners of a business but also to those who may otherwise use the firm's report. The firm and its personnel must be free from any obligation to or interest in the client, its management, or its owners<sup>6</sup>. *Integrity* requires personnel to be honest and candid within the constraints of client 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 firm's services. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest.

**Personnel Management**

- .11 A firm's quality control system depends heavily on the proficiency of its personnel. In making assignments, the nature and extent of supervision to be provided should be considered. Generally, the more able and experienced the personnel assigned to a particular engagement, the less direct supervision is needed.

---

<sup>5</sup> Independence requirements set forth in Rule 101 of the AICPA Code of Professional Conduct and the rules of applicable regulatory agencies such as state boards of accountancy, the Securities and Exchange Commission, the U.S. General Accounting Office, and the U.S. Department of Labor.

<sup>6</sup> See AICPA, *Professional Standards*, vol. 1, AU sec. 220.02.

- .12 The quality of a firm's work ultimately depends on the integrity, objectivity, intelligence, competence, experience, and motivation of personnel who perform, supervise, and review the work. Thus, a firm's personnel management policies and procedures factor into maintaining such quality.
- .13 *Personnel Management* encompasses hiring, assigning personnel to engagements, professional development, and advancement activities. Accordingly, policies and procedures should be established to provide the firm with reasonable assurance that-
- a. Those hired possess the appropriate characteristics to enable them to perform competently.
  - b. Work is assigned to personnel having the degree of technical training and proficiency required in the circumstances.
  - c. Personnel participate in general and industry-specific continuing professional education and other professional development activities that enable them to fulfill responsibilities assigned, and satisfy applicable continuing professional education requirements of the AICPA and regulatory agencies.<sup>7</sup>
  - d. Personnel selected for advancement have the qualifications necessary for fulfillment of the responsibilities they will be called on to assume.

#### **Acceptance and Continuance of Clients and Engagements**

- .14 Policies and procedures should be established for deciding whether to accept or continue a client relationship and whether to perform a specific engagement for that client. Such policies and procedures should provide the firm with reasonable assurance that the likelihood of association with a client whose management lacks integrity is minimized. Establishing such policies and procedures does not imply that a firm vouches for the integrity or reliability of a client, nor does it imply that a firm has a duty to any person or entity but itself with respect to the acceptance, rejection, or retention of clients. However, prudence suggests that a firm be selective in determining its client relationships and

---

<sup>7</sup> Regulatory agencies that have established continuing education requirements include state boards of accountancy and the U.S. General Accounting Office.

the professional services it will provide.

- .15 Such policies and procedures should also provide reasonable assurance that the firm—
  - a. Undertakes only those engagements that the firm can reasonably expect to be completed with professional competence.
  - b. Appropriately considers the risks associated with providing professional services in the particular circumstances.
- .16 To minimize the risk of misunderstandings regarding the nature, scope, and limitations of the services to be performed, policies and procedures should provide for obtaining an understanding with the client regarding those services. Professional standards may provide guidance in deciding whether the understanding should be oral or written.

#### **Engagement Performance**

- .17 Policies and procedures should be established to provide the firm with reasonable assurance that the work performed by engagement personnel meets applicable professional standards, regulatory requirements, and the firm's standards of quality.
- .18 Policies and procedures for *Engagement Performance* encompass all phases of the design and execution of the engagement. To the extent appropriate and as required by applicable professional standards, these policies and procedures should cover planning, performing, supervising, reviewing, documenting, and communicating the results of each engagement. Where applicable, these policies and procedures should also address the concurring partner review requirements applicable to SEC engagements as set forth in membership requirements of the SEC Practice Section of the AICPA.
- .19 Policies and procedures should also be established to provide reasonable assurance that personnel refer to authoritative literature or other sources and consult, on a timely basis, with individuals within or outside the firm, when appropriate (for example, when dealing with complex, unusual, or unfamiliar issues). Individuals consulted should have appropriate levels of knowledge, competence, judgment, and authority. The nature of the arrangements for consultation depends on a number of factors, including the size of the firm and the levels of knowledge, competence, and judgment possessed by the persons performing the work.

### Monitoring

- .20 Policies and procedures should be established to provide the firm with reasonable assurance that the policies and procedures established by the firm for each of the other elements of quality control described in paragraphs .07 through .19 are suitably designed and are being effectively applied.<sup>8</sup> *Monitoring* involves an ongoing consideration and evaluation of the-
- a. Relevance and adequacy of the firm's policies and procedures.
  - b. Appropriateness of the firm's guidance materials and any practice aids.
  - c. Effectiveness of professional development activities.
  - d. Compliance with the firm's policies and procedures. When monitoring, the effects of the firm's management philosophy and the environment in which the firm practices and its clients operate should be considered.

### Administration of a Quality Control System

- .21 To provide reasonable assurance that the firm's quality control system achieves its objectives, appropriate consideration should be given to the assignment of quality control responsibilities within the firm, the means by which quality control policies and procedures are communicated, and the extent to which the policies and procedures and compliance therewith should be documented.

### Assignment of Responsibilities

- .22 Responsibility for the *design* and *maintenance* of the various quality control policies and procedures should be assigned to an appropriate individual or individuals in the firm. In making that assignment, consideration should be given to the proficiency of the individuals, the authority to be delegated to them, and the extent of supervision to be provided. However, all of the firm's personnel are responsible for *complying* with the firm's quality control policies and procedures.

---

<sup>8</sup> See Statement on Quality Control Standards No. 3, *Monitoring a CPA Firm's Accounting and Auditing Practice*.

**Communication**

- .23 A firm should communicate its quality control policies and procedures to its personnel in a manner that provides reasonable assurance that those policies and procedures are understood and complied with. The form and extent of such communications should be sufficiently comprehensive to provide the firm's personnel with an understanding of the quality control policies and procedures applicable to them. In addition, a firm should establish a means of communicating its established quality control policies and procedures, and the changes thereto, to appropriate personnel on a timely basis.

**Documentation of Quality Control Policies and Procedures**

- .24 The size, structure, and nature of the practice of the firm should be considered in determining whether documentation of established quality control policies and procedures is required for effective communication and, if so, the extent of such documentation. For example, documentation of established quality control policies and procedures would generally be expected to be more extensive in a large firm than in a small firm and in a multioffice firm than in a single-office firm. Although communication ordinarily is enhanced if it is in writing, the effectiveness of a firm's system of quality control is not necessarily impaired by the absence of documentation of established quality control policies and procedures.

**Documentation of Compliance With Quality Control Policies and Procedures**

- .25 A firm should prepare appropriate documentation to demonstrate compliance with its policies and procedures for the quality control system discussed herein. The form and content of such documentation is a matter of judgment and depends on a number of factors, such as the size of a firm, the number of offices, the degree of authority allowed its personnel and its offices, the nature and complexity of the firm's practice, its organization, and appropriate cost-benefit considerations. Documentation should be retained for a period of time sufficient to enable those performing monitoring procedures and a peer review to evaluate the extent of the firm's compliance with its quality control policies and procedures.



**Effective Date**

- .26 The provisions of this section are applicable to a CPA firm's system of quality control for its accounting and auditing practice as of January 1, 1997.
-

10012      **Statement on Quality Control Standards 2 and 4**

*This Statement entitled System of Quality Control for a CPA Firm's Accounting and Auditing Practice was adopted unanimously by the fifteen members of the board.*

**Auditing Standards Board (1995)**

Edmund R. Noonan, *Chair*  
Luther E. Birdzell  
James E. Brown  
Robert E. Fleming  
John A. Fogarty, Jr.  
James S. Gerson  
Norwood J. Jackson, Jr.  
John J. Kilkeary  
Deborah D. Lambert  
Stephen M. McEachern  
Charles J. McElroy  
Kurt Pany

Edward F. Rockman  
Glenn J. Vice  
W. Ronald Walton

---

Dan M. Guy  
*Vice President, Professional  
Standards and Services*  
Kim M. Gibson  
*Technical Manager  
Audit and Attest Standards*

The board gratefully acknowledges the Joint Task Force on Quality Control Standards for its significant contribution.

**Joint Task Force on Quality Control Standards-  
Accounting and Auditing  
(1994-1995)**

Barry Barber, *Chair*  
James E. Brown  
John R. Burzenski  
Edwin G. Jolicoeur  
Charles E. Landes

---

Dale R. Atherton  
*(Past) Vice President  
Peer Review*  
Kim M. Gibson  
*Technical Manager  
Audit and Attest Standards*

Arleen Rodda Thomas  
*Vice President, Self  
Regulation and SECPS*

James V. Carey  
*Project Manager*

The amendment to paragraph 18 promulgated by Statement on Quality Control Standards No. 4 was adopted unanimously by the fifteen members of the board.

**Auditing Standards Board (1999)**

Deborah D. Lambert, Chair  
James S. Gerson, Vice-Chair  
John T. Barnum  
Andrew J. Capelli  
Robert F. Dacey  
Richard Dieter  
Sally L. Hoffman  
Stephen D. Holton  
J. Michael Inzina  
Charles E. Landes  
Keith O. Newton  
Alan Rosenthal

R.C. Steiner  
George H. Tucker III  
Oliver R. Whittington

---

Arleen R. Thomas  
*Vice-President, Professional  
Standards  
and Services*

Thomas Ray  
*Director  
Audit and Attest Standards*

The Board gratefully acknowledges the Joint Task Force on Quality Control Standards and the SEC Practice Section Task Force on Concurring Partner Review for their significant contributions.

**Accounting and Auditing  
Joint Task Force on Quality Control Standards -  
(1998-1999)**

Barry Barber, Chair  
Robert E. Fleming  
Lester L. Fordham  
Charles E. Landes  
Richard L. Miller  
Ray Roberts

Susan S. Coffey  
*Vice-President, Self  
Regulation and SECPS*

David Brumbeloe  
*Director, SEC Practice*

## APPENDIX B

## Statement on Quality Control Standards 3

Issued by the Auditing Standards Board  
May 1996

*Monitoring a CPA Firm's Accounting and Auditing Practice*

Statements on Quality Control Standards are issued by the Auditing Standards Board. Firms that are enrolled in an Institute-approved practice-monitoring program are obligated to adhere to Quality Control Standards established by the Institute.

**Introduction**

- .01 This section provides guidance on how a CPA firm implements the monitoring element of a quality control system in its accounting and auditing practice.<sup>1</sup>
- .02 Statement on Quality Control Standards No. 2, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, describes Monitoring as one of the five elements of quality control. It provides that a CPA firm<sup>2</sup> should establish policies and procedures to provide the firm with reasonable assurance that the policies and procedures relating to each of the other elements of quality control are suitably designed and are being effectively applied. Monitoring involves an ongoing consideration and evaluation of the-

---

<sup>1</sup> *Accounting and auditing practice* refers to all audit, attest, accounting and review, and other services for which standards have been established by the AICPA Auditing Standards Board or the AICPA Accounting and Review Services Committee under rule 201 or 202 of the AICPA Code of Professional Conduct (AICPA, *Professional Standards*, vol. 2, ET secs. 201 and 202). Standards may also be established by other AICPA senior technical committees; engagements that are performed in accordance with those standards are not encompassed in the definition of an accounting and auditing practice.

<sup>2</sup> A *firm* is defined in the AICPA Code of Professional Conduct as "a form of organization permitted by state law or regulation whose characteristics conform to resolutions of Council that is engaged in the practice of public accounting, including the individual owners thereof" (AICPA, *Professional Standards*, vol. 2, ET sec. 92.05).

- a. Relevance and adequacy of the firm's policies and procedures.
- b. Appropriateness of the firm's guidance materials and any practice aids.
- c. Effectiveness of professional development activities.
- d. Compliance with the firm's policies and procedures.

When monitoring, the effects of the firm's management philosophy and the environment in which the firm practices and its clients operate should be considered.

#### Monitoring Procedures

.03 Monitoring procedures taken as a whole should enable the firm to obtain reasonable assurance that its system of quality control is effective. Procedures that provide the firm with a means of identifying and communicating circumstances that may necessitate changes to or the need to improve compliance with the firm's policies and procedures contribute to the monitoring element. A firm's monitoring procedures may include-

- Inspection procedures. (See paragraphs .04 through .07.)
- Preissuance or postissuance review of selected engagements. (See paragraphs .08 and .09.)
- Analysis and assessment of-
  - New professional pronouncements.
  - Results of independence confirmations.
  - Continuing professional education and other professional development activities undertaken by firm personnel.<sup>3</sup>
  - Decisions related to acceptance and continuance of client relationships and engagements.
  - Interviews of firm personnel.

---

<sup>3</sup> The term *personnel* refers to all individuals who perform professional services for which the firm is responsible, whether or not they are CPAs.

- Determination of any corrective actions to be taken and improvements to be made in the quality control system. Communication to appropriate firm personnel of any weaknesses identified in the quality control system or in the level of understanding or compliance therewith.
  - Follow-up by appropriate firm personnel to ensure that any necessary modifications are made to the quality control policies and procedures on a timely basis.
- .04 Inspection procedures evaluate the adequacy of the firm's quality control policies and procedures, its personnel's understanding of those policies and procedures, and the extent of the firm's compliance with its quality control policies and procedures. Inspection procedures contribute to the monitoring function because findings are evaluated and changes in or clarifications of quality control policies and procedures are considered.
- .05 The need for and extent of inspection procedures depends in part on the existence and effectiveness of the other monitoring procedures. Factors to be considered in determining the need for and extent of inspection procedures include, but are not limited to-
- The nature, complexity, and diversity of, and the risks associated with, the firm's practice.
  - The firm's size, number of offices, degree of authority allowed its personnel and its offices, and organizational structure.
  - The results of recent practice reviews and previous inspection procedures.<sup>4</sup>
  - Appropriate cost-benefit considerations.<sup>5</sup>
- .06 The nature of inspection procedures will vary based on the firm's quality control policies and procedures and the effectiveness and results of other monitoring procedures. The

---

<sup>4</sup> Practice reviews include, but are not limited to, peer reviews performed under standards established by the AICPA and reviews conducted by regulatory agencies.

<sup>5</sup> Although appropriate cost-benefit considerations may be considered in determining the need for and extent of inspection procedures, a firm must still effectively monitor its practice.

adequacy of and compliance with a firm's quality control system are evaluated by performing such inspection procedures as-

- Review of selected administrative and personnel records pertaining to the quality control elements.
- Review of engagement working papers, reports, and clients' financial statements. (See also paragraphs .08 and .09.)
- Discussions with the firm's personnel.
- Summarization of the findings from the inspection procedures, at least annually, and consideration of the systemic causes of findings that indicate improvements are needed.
- Determination of any corrective actions to be taken or improvements to be made with respect to the specific engagements reviewed or the firm's quality control policies and procedures.
- Communication of the identified findings to appropriate firm management personnel.
- Consideration of inspection findings by appropriate firm management personnel who should also determine that any actions necessary, including necessary modifications to the quality control system, are taken on a timely basis.

Inspection procedures with respect to the engagement performance element of a quality control system are particularly appropriate in a firm with more than a limited number of management-level individuals<sup>6</sup> responsible for the conduct of its accounting and auditing practice.

- .07 Inspection procedures may be performed at a fixed time(s) during the year covering a specified period(s) of time or as part of ongoing quality control procedures, or a combination thereof.

---

<sup>6</sup> The term *management-level individual* refers to all owners of a firm and other individuals within the firm with a managerial position as described in Interpretation 101-9 of the Code of Professional Conduct (AICPA, *Professional Standards*, vol. 2, ET sec. 101.11).

- .08 Procedures for carrying out preissuance or postissuance review of engagement working papers, reports, and clients' financial statements by a qualified management-level individual (or by a qualified individual under his or her supervision) may be considered part of the firm's monitoring procedures provided that those performing or supervising such preissuance or postissuance reviews are *not directly associated with the performance of the engagement*. Such preissuance or postissuance review procedures may constitute inspection procedures provided-
- a. The review is sufficiently comprehensive to enable the firm to assess compliance with all applicable professional standards and the firm's quality control policies and procedures.
  - b. Findings of such reviews that may indicate the need to improve compliance with or modify the firm's quality control policies and procedures are periodically summarized, documented, and communicated to the firm's management personnel having the responsibility and authority to make changes in those policies and procedures.
  - c. The firm's management personnel consider on a timely basis the systemic causes of findings that indicate improvements are needed and determine appropriate actions to be taken.
  - d. The firm implements on a timely basis such planned actions, communicates changes to personnel who might be affected, and follows up to determine that the planned actions were taken.

A preissuance and, except as described in paragraph .09, a postissuance review of engagement working papers, reports, and clients' financial statements by the person with final responsibility for the engagement does not constitute a monitoring procedure.

- .09 In small firms with a limited number of qualified management-level individuals, postissuance review of engagement working papers, reports, and clients' financial statements by the person with final responsibility for the engagement may constitute inspection procedures, provided the provisions in paragraph .08a-d are followed. (See also paragraph .11.)



**Monitoring in Small Firms With a Limited Number of Management-Level Individuals**

- .10 In small firms with a limited number of management-level individuals, monitoring procedures may need to be performed by some of the same individuals who are responsible for compliance with the firm's quality control policies and procedures. To effectively monitor one's own compliance with the firm's policies and procedures, an individual must be able to critically review his or her own performance, assess his or her own strengths and weaknesses, and maintain an attitude of continual improvement. Changes in conditions and in the environment within the firm (such as obtaining clients in an industry not previously serviced or significantly changing the size of the firm) may indicate the need to have quality control policies and procedures monitored by another qualified individual.
- .11 The performance of inspection procedures in firms with a limited number of management-level individuals can assist the firm in the monitoring process. An individual inspecting his or her own compliance with a quality control system may be inherently less effective than having such compliance inspected by another qualified individual. When one individual inspects his or her own compliance, the firm may have a higher risk that noncompliance with policies and procedures will not be detected. Accordingly, a firm in this circumstance may find it beneficial to engage a qualified individual from outside the firm to perform inspection procedures.

**The Relationship of Peer Review to Monitoring**

- .12 A peer review does not substitute for monitoring procedures. However, since the objective of a peer review is similar to that of inspection procedures, a firm's quality control policies and procedures may provide that a peer review conducted under standards established by the AICPA may substitute for some or all of its inspection procedures for the period covered by the peer review.

**Effective Date**

- .13 The provisions of this section are applicable to a CPA firm's system of quality control for its accounting and auditing practice as of January 1, 1997.
-

# ***SEC PRACTICE SECTION REFERENCE MANUAL***

**ORGANIZATIONAL DOCUMENTS  
STANDARDS FOR PEER REVIEW  
ADMINISTRATION**



**Division for  
CPA Firms**  
AICPA

*This Statement entitled Monitoring a CPA Firm's Accounting and Auditing Practice was adopted unanimously by the fifteen members of the board.*

**Auditing Standards Board (1995)**

Edmund R. Noonan, *Chair*  
Luther E. Birdzell  
James E. Brown  
Robert E. Fleming  
John A. Fogarty, Jr.  
James S. Gerson  
Norwood J. Jackson, Jr.  
John J. Kilkeary  
Deborah D. Lambert  
Stephen M. McEachern  
Charles J. McElroy  
Kurt Pany

Edward F. Rockman  
Glenn J. Vice  
W. Ronald Walton

---

Dan M. Guy  
*Vice President, Professional  
Standards and Services*  
Kim M. Gibson  
*Technical Manager  
Audit and Attest Standards*

The board gratefully acknowledges the Joint Task Force on Quality Control Standards for its significant contribution.

**Note:** *Statements on Quality Control Standards are issued by the Auditing Standards Board. Firms that are enrolled in an Institute-approved practice-monitoring program are obligated to adhere to quality control standards established by the Institute.*

**Joint Task Force on Quality Control Standards-  
Accounting and Auditing  
(1994-1995)**

Barry Barber, *Chair*  
James E. Brown  
John R. Burzenski  
Edwin G. Jolicoeur  
Charles E. Landes

---

Dale R. Atherton  
*(Past) Vice President  
Peer Review*  
Kim M. Gibson  
*Technical Manager  
Audit and Attest Standards*

Arleen Rodda Thomas  
*Vice President, Self  
Regulation and SECPS*

James V. Carey  
*Project Manager*

## APPENDIX C

**Statement on Quality Control Standards 5**

Issued by the Auditing Standards Board  
January 2000

*The Personnel Management Element of a Firm's System of Quality Control-Competencies Required by a Practitioner-in-Charge of an Attest Engagement*

Statements on Quality Control Standards are issued by the Auditing Standards Board. Firms that are enrolled in an Institute-approved practice-monitoring program are obligated to adhere to Quality Control Standards established by the Institute.

**Introduction**

.01 Statement on Quality Control Standards (SQCS) No. 2, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice* (AICPA Professional Standards, vol. 2, QC sec. 20), provides that a CPA firm shall have a system of quality control for its accounting and auditing practice<sup>1</sup> that should encompass the following elements:

- a. Independence, integrity, and objectivity
- b. Personnel management
- c. Acceptance and continuance of clients and engagements
- d. Engagement performance
- e. Monitoring

**The Personnel Management Element Of Quality Control**

.02 *Personnel Management* encompasses hiring, assigning personnel

---

<sup>1</sup> *Accounting and auditing practice* refers to all accounting, audit, and attestation services for which standards have been established by the AICPA Auditing Standards Board or the AICPA Accounting and Review Services Committee under rule 201 or 202 of the AICPA Code of Professional Conduct (AICPA Professional Standards, vol. 2, ET sec. 201 and 202). Standards may also be established by other AICPA senior technical committees; engagements that are performed in accordance with those standards are not encompassed in the definition of an accounting, auditing, and attestation practice.

to engagements, professional development, and advancement activities. Accordingly, policies and procedures should be established to provide the firm with reasonable assurance that—

- a. Those hired possess the appropriate characteristics to enable them to perform competently. Examples of such characteristics may include meeting minimum academic requirements established by the firm, maturity, integrity, and leadership traits.
  - b. Work is assigned to personnel having the degree of technical training and proficiency required in the circumstances.
  - c. Personnel participate in general and industry-specific continuing professional education and other professional development activities that enable them to fulfill responsibilities assigned, and satisfy applicable continuing professional education requirements of the AICPA, and regulatory agencies.<sup>2</sup>
  - d. Personnel selected for advancement have the qualifications necessary for fulfillment of the responsibilities they will be called on to assume.
03. This Statement clarifies the requirements of the personnel management element of a firm's system of quality control. In light of the significant responsibilities during the planning and performance of accounting, auditing, and attestation engagements of individuals who are responsible for supervising accounting, auditing, and attestation engagements and signing or authorizing an individual to sign the accountants report on such engagements, a firm's policies and procedures related to the items noted in paragraph<sup>2</sup> above should be designed to provide a firm with reasonable assurance that such individuals possess the kinds of competencies that are appropriate given the circumstances of individual client engagements. For purposes of this standard, such an individual is referred to as the practitioner-in-charge of the engagement.

#### Competencies

- .04 Competencies are the knowledge, skills, and abilities that enable a practitioner-in-charge to be qualified to perform an

---

<sup>2</sup> Regulatory agencies that have established continuing education requirements include state boards of accountancy and the U.S. General Accounting Office.

accounting, auditing, or attestation engagement. A firm is expected to determine the kinds of competencies that are necessary in the individual circumstances. Competencies are not measured by periods of time because such a quantitative measurement may not accurately reflect the kinds of experiences gained by a practitioner in any given time period. Accordingly, for purposes of this Statement, a measure of overall competency is qualitative rather than quantitative.

### **Gaining Competencies**

- .05 A firm's policies and procedures would ordinarily require a practitioner-in-charge of an engagement to gain the necessary competencies through recent experience in accounting, auditing, and attestation engagements. In some cases, however, a practitioner-in-charge will have obtained the necessary competencies through disciplines other than the practice of public accounting, such as in relevant industry, governmental, and academic positions. If necessary, the experience of the practitioner-in-charge should be supplemented by continuing professional education (CPE) and consultation. The following are examples.
- A practitioner-in-charge of an engagement whose recent experience has consisted primarily in providing tax services may acquire the competencies necessary in the circumstances to perform a compilation or review engagement by obtaining relevant CPE.
  - A practitioner-in-charge of an engagement who did not have any experience in auditing the financial statements of a public company and only possessed recent prior experience in auditing the financial statements of nonpublic entities may develop the necessary competencies by obtaining relevant CPE related to SEC rules and regulations and consulting with other practitioners who possess relevant knowledge related to SEC rules and regulations.
  - A practitioner-in-charge of an engagement who did not have any experience in auditing the financial statements of a public company but possessed prior public accounting practice experience auditing financial statements of nonpublic entities and who also has relevant experience as the controller of a public company may have the necessary competencies in the circumstances.
  - A practitioner-in-charge of an engagement whose actual experience consists of performing review and compilation engagements may be able to obtain the necessary

competencies to perform an audit by becoming familiar with the industry in which the client operates, obtaining continuing professional education relating to auditing, and/or using consulting sources during the course of performing the audit engagement.

- A person in academia might obtain the necessary competencies to perform accounting, auditing or attestation engagements by (a) obtaining specialized knowledge through teaching or authorship of research projects or similar papers, and (b) a rigorous self-study program or by engaging a consultant to assist on such engagements.
- .06 Regardless of the manner in which a particular competency is gained, a firm's quality control policies and procedures should be adequate to provide reasonable assurance that a practitioner-in-charge of an engagement possesses the competencies necessary to fulfill his or her engagement responsibilities.
- .07 The nature and extent of competencies established by a firm that are expected of the practitioner-in-charge of an engagement should be based on the characteristics of a particular client, industry, and the kind of service being provided. For example, the following should be considered.
- The competencies expected of a practitioner-in-charge of an engagement to compile financial statements would be different than those expected of a practitioner engaged to review or audit financial statements.
  - Supervising engagements and signing or authorizing others to sign reports for clients in certain industries or engagements, such as financial services, governmental, or employee benefit plan engagements, would require different competencies than what would be expected in performing attest services for clients in other industries.
  - The practitioner-in-charge of an engagement to audit the financial statements of a public company would be expected to have certain technical proficiency in SEC reporting requirements, while a practitioner-in-charge who is not assigned to the audits of public companies would not need to be proficient in this area. This would include, for example, experience in the industry and appropriate knowledge of SEC and ISB rules and regulations, including accounting and independence standards.
  - The practitioner-in-charge of an attestation engagement to

examine management's assertion about the effectiveness of an entity's internal control over financial reporting would be expected to have certain technical proficiency in understanding and evaluating the effectiveness of controls, while a practitioner-in-charge of an attestation engagement to examine investment performance statistics would be expected to have different competencies, including an understanding of the subject matter of the underlying assertion.

**Competencies Expected in Performing Accounting, Auditing, and Attestation Engagements**

08. In practice, the kinds of competency requirements that a firm should establish for the practitioner-in-charge of an engagement are necessarily broad and varied in both their nature and number. However, the firm's quality control policies and procedures should ordinarily address the following competencies for the practitioner-in-charge of an engagement. Firms policies and procedures should also address other competencies as necessary in the circumstances.
- a. *Understanding of the Role of a System of Quality Control and the Code of Professional Conduct*-Practitioners-in-charge of an engagement should possess an understanding of the role of a firm's system of quality control and the AICPA's Code of Professional Conduct, both of which play critical roles in assuring the integrity of the various kinds of accountant's reports.
  - b. *Understanding of the Service to be Performed*-Practitioners-in-charge of an engagement should possess an understanding of the performance, supervision, and reporting aspects of the engagement, which is normally gained through actual participation in that kind of engagement under appropriate supervision.
  - c. *Technical Proficiency*-Practitioners-in-charge of an engagement should possess an understanding of the applicable accounting, auditing, and attest professional standards including those standards directly related to the industry in which a client operates and the kinds of transactions in which a client engages.
  - d. *Familiarity with the Industry*-To the extent required by professional standards applicable to the kind of service being performed, practitioners-in-charge of an engagement should possess an understanding of the industry in which a client operates. In performing an audit or review of



financial statements, this understanding would include an industry's organization and operating characteristics sufficient to identify areas of high or unusual risk associated with an engagement and to evaluate the reasonableness of industry specific estimates.

- e. *Professional Judgment-Practitioners-in-charge* of an engagement should possess skills that indicate sound professional judgment. In performing an audit or review of financial statements, such skills would typically include the ability to exercise professional skepticism and identify areas requiring special consideration including, for example, the evaluation of the reasonableness of estimates and representations made by management and the determination of the kind of report necessary in the circumstances.
- f. *Understanding the Organization's Information Technology Systems-Practitioners-in-charge* of an audit engagement should have an understanding of how the organization is dependent on or enabled by information technologies; and the manner in which information systems are used to record and maintain financial information.

#### **Interrelationship of Competencies and Other Elements of a Firm's System of Quality Control**

- 09. The competencies listed above are interrelated and gaining one particular competency may be related to achieving another. For example, familiarity with the client's industry interrelates with a practitioner's ability to make professional judgments relating to the client.
- .10 In establishing policies and procedures related to the nature of competencies needed by the practitioner-in-charge of an engagement, a firm may need to consider the requirements of policies and procedures established for other elements of quality control. For example, a firm would consider its requirements related to engagement performance in determining the nature of any competency requirements that assess the degree of technical proficiency necessary in a given set of circumstances.

#### **The Relationship of the Competency Requirement of the Uniform Accountancy Act to the Personnel Management Element of Quality Control**

- .11 The Uniform Accountancy Act (UAA) is a model legislative statute and related administrative rules that the AICPA and

the National Association of State Boards of Accountancy (NASBA) designed to provide a uniform approach to the regulation of the accounting profession. CPAs are not required to follow the provisions of the UAA itself but rather the accountancy laws of the individual licensing jurisdictions in the United States governing the practice of public accounting, which may have adopted the UAA in whole or in part. The UAA provides that "any individual licensee who is responsible for supervising attest or compilation services and signs or authorizes someone to sign the accountant's report on the financial statements on behalf of the firm shall meet the competency requirements set out in the professional standards for such services". A firm's compliance with this Statement is intended to enable a practitioner who performs the services described in the preceding sentence on the firm's behalf to meet this competency requirement; however, this Statement's applicability is broader than what is required by the UAA since the definition of an accounting and auditing practice in quality control standards encompasses a wider range of attest engagements.

**EFFECTIVE DATE**

- .12 The provisions of this Statement are applicable to a CPA firm's system of quality control for its accounting and auditing practice as of June 30, 2000. Earlier implementation is encouraged.

*This Statement entitled System of Quality Control for A CPA Firm's Accounting and Auditing Practice was adopted unanimously by the fifteen members of the board.*

**Auditing Standards Board (1999)**

Deborah D. Lambert, Chair  
James S. Gerson, Vice-Chair  
John T. Barnum  
Andrew J. Capelli  
Robert F. Dacey  
Richard Dieter  
Sally L. Hoffman  
Stephen D. Holton  
J. Michael Inzina  
Charles E. Landes  
Keith O. Newton  
Alan Rosenthal

R.C. Steiner  
George H. Tucker III  
Oliver R. Whittington

---

Arleen R. Thomas  
*Vice-President, Professional  
Standards and Services*

Thomas Ray  
*Director  
Audit and Attest Standards*

The Board gratefully acknowledges the Joint Task Force on Quality Control Standards for their significant contributions.

**Note:** *Statements on Quality Control Standards are issued by the Auditing Standards Board. Firms that are enrolled in an Institute-approved practice-monitoring program are obligated to adhere to quality control standards established by the Institute.*

**Joint Task Force on Quality Control Standards -  
Accounting and Auditing  
(1998-1999)**

Barry Barber, Chair  
Robert E. Fleming  
Lester L. Fordham  
Charles E. Landes  
Richard L. Miller  
Ray Roberts

Susan S. Coffey  
*Vice-President, Self-Regulation  
and SECPS*

David Brumeloe  
*Director, SEC Practice Section*

---

Anthony J. Pugliese  
*Director, Assurance Services*

**Guide for Establishing and Maintaining a System of Quality Control  
for a CPA Firm's Accounting and Auditing Practice**

Recommendations of the AICPA Joint Task Force on Quality Control  
Standards

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

**NOTICE TO READERS**

This Guide presents recommendations of the AICPA Joint Task Force on Quality Control Standards (task force) on the application of Statements on Quality Control Standards. This Guide has not been approved, disapproved, or otherwise acted on by the Auditing Standards Board, the membership, or the governing body of the American Institute of Certified Public Accountants. Therefore, the contents of the Guide, including the recommendations, are not authoritative.

The suggested policies and procedures presented herein are illustrative only and firms are encouraged to consider these examples in designing and maintaining a quality control system that is appropriate for their accounting and auditing practice. A firm's policies and procedures should be sufficient for it to obtain reasonable assurance of complying with the requirements of Statements on Quality Control Standards, which, in turn, should be sufficient for a firm to obtain reasonable assurance of complying with professional standards. In considering an appropriate quality control system for its accounting and auditing practice, a firm should be aware that although some of the illustrative procedures are not explicitly required by professional standards, they present the views of the task force regarding an appropriate quality control system. The views of the task force are provided through illustrative examples of four hypothetical firms and their systems of quality control.

**Joint Task Force on Quality Control Standards (1996)**

Barry Barber, Chair  
James E. Brown  
John R. Burzenski  
Edwin G. Jolicoeur  
Charles E. Landes  
Glenn J. Vice

Kim M. Gibson  
*Technical Manager*  
*Audit and Attest Standards*  
  
James V. Carey  
*Project Manager*

Copyright © 1996 by  
American Institute of Certified Public Accountants, Inc.,  
New York, NY 10036-8775

All rights reserved. Requests for permission to make copies of any part of this work should be mailed to Permissions Department, AICPA, Harborside Financial Center, 201 Plaza Three, Jersey City, NJ 07311-3881.

1234567890 AAS 99876

## Table of Contents

	Paragraph
<b>1 Overview of Statements on Quality Control Standards</b>	.01 - .17
Independence, Integrity, and Objectivity	.07 - .08
Personnel Management	.09 - .10
Acceptance and Continuance of Clients and Engagements	.11 - .12
Engagement Performance	.13 - .14
Monitoring	.15 - .16
Illustrative Examples	.17
<b>2 National CPA Firm's System of Quality Control for Its Accounting and Auditing Practice</b>	.01 - .45
Independence, Integrity, and Objectivity	.02 - .09
Personnel Management	.10 - .19
Acceptance and Continuance of Clients and Engagements	.20 - .27
Engagement Performance	.28 - .35
Monitoring	.36 - .45
<b>3 Regional Accountants' System of Quality Control for Its Accounting and Auditing Practice</b>	.01 - .45
Independence, Integrity, and Objectivity	.02 - .09
Personnel Management	.10 - .19
Acceptance and Continuance of Clients and Engagements	.20 - .27
Engagement Performance	.28 - .35
Monitoring	.36 - .45

## Table of Contents (continued)

	Paragraph
<b>4 AnyCity CPAs' System of Quality Control for Its Accounting and Auditing Practice</b>	.01 - .48
Independence, Integrity, and Objectivity	.02 - .09
Personnel Management	.10 - .19
Acceptance and Continuance of Clients and Engagements	.20 - .27
Engagement Performance	.28 - .35
Monitoring	.36 - .48
<b>5 Jane Brown, CPA's System of Quality Control for Her Accounting Practice</b>	.01 - .37
Independence, Integrity, and Objectivity	.02 - .05
Personnel Management	.06 - .11
Acceptance and Continuance of Clients and Engagements	.12 - .19
Engagement Performance	.20 - .27
Monitoring	.28 - .37
	<b>Page</b>
<b>Glossary of Selected Terms</b>	10081

**Guide for Establishing and Maintaining a System of Quality 10035  
Control for a CPA Firm's Accounting and Auditing Practice**

**Chapter 1**

**Overview of Statements on Quality Control Standards**

1.01. Statement on Quality Control Standards (SQCS) No. 2, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice* (AICPA, *Professional Standards*, vol. 2, QC sec. 20), provides that a CPA firm shall have a system of quality control for its accounting and auditing practice and describes the elements of quality control and other matters essential to the effective implementation and maintenance of the system. A system of quality control is broadly defined as a process to provide the firm with reasonable assurance that its personnel comply with applicable professional standards and the firm's standards of quality.

1.02. SQCS No. 2, paragraph 4, provides that the nature, extent, and formality of a firm's quality control policies and procedures depend on a number of factors, such as its size, the number of its offices, the degree of authority allowed its personnel and its offices, the knowledge and experience of its personnel, the nature and complexity of its practice, and appropriate cost-benefit considerations.

1.03. A firm should establish a system of quality control that includes policies and procedures related to each of the five elements of quality control identified in SQCS No. 2, which are as follows:

- a. *Independence, Integrity, and Objectivity*
- b. *Personnel Management*
- c. *Acceptance and Continuance of Clients and Engagements*
- d. *Engagement Performance*
- e. *Monitoring*

1.04. The monitoring element of quality control is further described in SQCS No. 3, *Monitoring a CPA Firm's Accounting and Auditing Practice* (AICPA, *Professional Standards*, vol. 2, QC sec. 30).

1.05. The elements of quality control are interrelated. For example, the maintenance of *Integrity, Objectivity*, and, where required, *Independence* requires a continuing assessment of client relationships that affect policies and procedures for the acceptance and continuance of clients and engagements. Similarly, the element of *Personnel Management* encompasses criteria for professional development, hiring, advancement, and assignment of the firm's personnel to engagements, which affect policies and procedures developed to meet the objectives of the quality control element of *Engagement Performance*. Similarly, policies and



**10036 Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice**

procedures for the quality control element of *Monitoring* evaluate whether the policies and procedures that are required by the firm related to each of the other four elements of quality control are suitably designed and are being effectively applied.

1.06. When a firm merges, acquires, sells or otherwise changes a portion of its practice, the surviving firm should evaluate and, as necessary, revise, implement, and maintain firm-wide quality control policies and procedures appropriate in light of the changed circumstances.

**Independence, Integrity, and Objectivity**

1.07. The objective of the *Independence, Integrity, and Objectivity* element of a system of quality control is to provide the firm with reasonable assurance that personnel maintain independence (in fact and in appearance) in all required circumstances, perform all professional responsibilities with integrity, and maintain objectivity in discharging professional responsibilities.

1.08. This objective ordinarily would be satisfied by establishing and maintaining policies such as-

- Requiring that personnel adhere to applicable independence, integrity, and objectivity requirements. Regulations, interpretations, and rulings of the AICPA, state CPA societies, state boards of accountancy, state statutes, the Securities and Exchange Commission (SEC), and other regulatory agencies should be considered where applicable.
- Communicating policies and procedures relating to independence, integrity, and objectivity to personnel.
- Confirming the independence of another firm engaged to perform part (or parts) of an engagement, or when acting as principal auditor.

**Personnel Management**

1.09. The objective of the *Personnel Management* element of a system of quality control is to provide the firm with reasonable assurance that all personnel have the proficiency to perform their assigned responsibilities. Attributes or qualities that enhance the proficiency of personnel who perform, supervise, or review work include integrity, objectivity, intelligence, judgment, competence, experience, and motivation.

1.10. This objective ordinarily would be satisfied by establishing and maintaining policies such as-

- Hiring personnel who possess the appropriate characteristics to enable them to perform competently.

**Guide for Establishing and Maintaining a System of Quality 10037  
Control for a CPA Firm's Accounting and Auditing Practice**

- Assigning personnel who have the degree of technical training and proficiency required in the circumstances. In making assignments, the nature and extent of supervision to be provided should be considered. Generally, the more qualified and experienced the personnel assigned to a particular engagement, the less direct supervision is needed. Conversely, the less qualified and less experienced the personnel assigned, the more direct supervision generally is needed.
- Having personnel participate in general and industry-specific continuing professional education and professional development activities that enable them to fulfill responsibilities assigned, and satisfy applicable continuing professional education requirements of the AICPA and regulatory agencies.
- Selecting for advancement only those who have the qualifications necessary for fulfillment of the responsibilities they will be called on to assume.

**Acceptance and Continuance of Clients and Engagements**

1.11. The objective of the *Acceptance and Continuance of Clients and Engagements* element of a system of quality control is to establish criteria for deciding whether to accept or continue a client relationship and whether to perform a specific engagement for that client. Such policies and procedures should provide the firm with reasonable assurance that (a) the likelihood of association with a client whose management lacks integrity is minimized, (b) the firm undertakes only those engagements that can be completed with professional competence, (c) the risks associated with providing professional services in particular circumstances are appropriately considered, and (d) an understanding is reached with the client regarding the services to be performed.

1.12. These objectives ordinarily would be satisfied, both with respect to the initial period for which the firm is performing its service and for subsequent periods, by establishing and maintaining policies such as-

- Evaluating factors that have a bearing on managements integrity.
- Evaluating whether the engagement the firm will perform can be completed with professional competence and, accordingly, undertaking only those engagements that can be completed with professional competence; and appropriately considering the risk associated with providing professional services in particular circumstances.
- Obtaining an understanding with the client regarding the services to be performed.

10038 Guide for Establishing and Maintaining a System of Quality  
Control for a CPA Firm's Accounting and Auditing Practice

**Engagement Performance**

1.13. The objective of the *Engagement Performance* element of a system of quality control is to provide the firm with reasonable assurance that the work performed by engagement personnel meets the applicable professional standards, regulatory requirements, and the firm's standards of quality. Policies and procedures for engagement performance encompass all phases of the design and execution of the engagement. To the extent appropriate and as required by applicable professional standards, these policies and procedures should cover planning, performing, supervising, reviewing, documenting, and communicating the results of each engagement. Policies and procedures should also provide that personnel refer to authoritative literature or other sources and consult, on a timely basis, with individuals within or outside the firm, when appropriate.

1.14. This objective ordinarily would be satisfied by establishing and maintaining policies such as-

- Requiring that all engagements be planned to meet professional, regulatory, and the firm's requirements.
- Requiring that the work performed and the reports and other communications issued meet professional, regulatory, and the firm's requirements.
- Identifying areas and specialized situations where consultation is necessary and requiring personnel to refer to authoritative literature or other sources or consult, on a timely basis, with individuals within or outside the firm, when appropriate (for example, when dealing with complex, unusual, or unfamiliar issues).

**Monitoring**

1.15. The objective of the *Monitoring* element of a system of quality control is to provide the firm with reasonable assurance that the policies and procedures relating to the other elements of quality control are suitably designed and being effectively applied. Monitoring is an ongoing consideration and evaluation process.

1.16. This objective ordinarily would be satisfied by establishing and maintaining policies for considering and evaluating, on an ongoing basis-

- The relevance and adequacy of the firm's quality control policies and procedures.
- The appropriateness of the firm's guidance materials and any practice aids.
- The effectiveness of professional development activities.

**Appendixes**

**Guide for Establishing and Maintaining a System of Quality 10039  
Control for a CPA Firm's Accounting and Auditing Practice**

- Compliance with the firm's policies and procedures.

**Illustrative Examples**

1.17. The remainder of this Guide provides illustrative examples of the types of policies a firm should consider for each of the elements of quality control. Each chapter provides examples of procedures that a firm might consider in implementing and maintaining such policies. The specific policies and procedures used by a firm would not necessarily include all those described or be limited to those illustrated. Most firms will find it appropriate to communicate their policies and procedures in writing. These examples are based on the assumption that each firm's quality control policies and procedures are in writing and distributed to all personnel. The illustrative examples are provided through four hypothetical firms— National CPA Firm, Regional Accountants, AnyCity CPAs, and Jane Brown, CPAX with the following characteristics—

- a. National CPA Firm is one of the largest firms in the country. It has sixty offices, eight hundred partners, five thousand professionals, five hundred publicly held clients, and it performs services for clients in a variety of industries. (Chapter 2)
- b. Regional Accountants has ten offices in three states and is centrally managed. Regional has thirty-five partners, two hundred professionals, and twenty-five SEC clients. In addition to servicing SEC clients, it has a concentration in audit and attest services for financial institutions. (Chapter 3)
- c. AnyCity CPAs is a local, one-office firm with three partners and ten professionals. Its accounting and auditing practice includes a concentration in employee benefit plan audits. AnyCity CPAs has no SEC clients. (Chapter 4)
- d. Jane Brown, CPA, is a sole owner without any professional staff, who occasionally hires per diem professionals. Her accounting practice consists only of services performed under Statements on Standards for Accounting and Review Services (SSARSS). (Chapter 5)

**10040 Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice**

**Chapter 2**

**National CPA Firm's System of Quality Control for Its Accounting and Auditing Practice**

2.01. This chapter describes how National CPA Firm implements each element of quality control for its accounting and auditing practice. National CPA Firm is a hypothetical firm. It is presumed to be one of the largest firms in the country. It has sixty offices, eight hundred partners, five thousand professionals, and five hundred publicly held clients, and performs services for clients in a variety of industries.

**Independence, Integrity, and Objectivity**

2.02. The objective of the *Independence, Integrity, and Objectivity* element of a system of quality control is to provide the firm with reasonable assurance that personnel maintain independence (in fact and in appearance) in all required circumstances, perform all professional responsibilities with integrity, and maintain objectivity in discharging professional responsibilities.

2.03. National CPA Firm satisfies this objective by establishing and maintaining the following policies and procedures.

**2.04. Policy 1**

**Personnel will adhere to applicable independence, integrity, and objectivity requirements. These requirements include regulations, interpretations, and rulings of the AICPA, state CPA societies, state boards of accountancy, state statutes, the Securities and Exchange Commission, and other regulatory agencies where applicable.**

2.05. National CPA Firm implements this policy by-

- a. Developing and maintaining a Professional Practice Manual that contains policies and procedures relating to independence, integrity, and objectivity. Such policies and procedures contain the firm's interpretations of professional and regulatory requirements, and guidance for identifying and resolving potential issues.
- b. Designating a quality assurance partner in each office to provide guidance, answer questions, and resolve matters.
- c. Designating a partner in its national office to answer more complex matters and determine the circumstances that might require consultation with sources outside the firm.
- d. Identifying circumstances where documentation of the resolution of matters is appropriate.

**Guide for Establishing and Maintaining a System of Quality 10041  
Control for a CPA Firm's Accounting and Auditing Practice**

- e. Obtaining written representations from personnel, upon hire and on an annual basis, stating whether they are familiar with and are in compliance with professional standards and the firm's policies and procedures regarding independence, integrity, and objectivity. The quality assurance partner in each office is responsible for obtaining such representations and reviewing compliance files for completeness. A partner in its national office is responsible for resolving reported exceptions.
- f. Requiring the managing partner in each office to periodically review unpaid fees from clients to ascertain whether any outstanding amounts impair the firm's independence.

**2.06. Policy 2**

**Personnel will be familiar with policies and procedures relating to independence, integrity, and objectivity.**

**2.07. National CPA Firm implements this policy by-**

- a. Providing each of its personnel with access to a personal computer and software that has access to databases containing professional and regulatory literature and advising them that they are expected to be familiar with that literature.
- b. Emphasizing the concepts of independence, integrity, and objectivity in its professional development meetings, in the acceptance and continuance of clients and engagements, and in the performance of engagements, including discussing the types of nonattest services that could impact independence.
- c. Informing personnel on a timely basis of those entities to which independence policies apply, by-
  - (1) Preparing and maintaining lists of entities to which independence policies apply.
  - (2) Making the lists available to personnel who need them to determine their independence (including personnel new to the firm or to an office, and certain former partners<sup>1</sup>).
  - (3) Notifying personnel of changes in the lists on a timely basis via a memorandum or the firm's E-mail system.

**2.08. Policy 3**

**Confirm the independence of another firm performing parts of an engagement, or when we act as principal auditor.**

---

<sup>1</sup> AICPA'S *Professional Standards*, vol. 2, ET sec. 101.04, discusses circumstances when activities of a former practitioner could affect the firm's independence.

**10042 Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice**

2.09. National CPA Firm implements this policy by-

- a. Describing in its Professional Practice Manual the form, content, and frequency of independence representations that are to be obtained.
- b. Requiring that such representations be documented.

**Personnel Management**

2.10. The objective of the *Personnel Management* element of a system of quality control is to provide the firm with reasonable assurance that all personnel have the proficiency to perform their assigned responsibilities. Attributes or qualities that enhance the proficiency of personnel who perform, supervise, or review work include integrity, objectivity, intelligence, judgment, competence, experience, and motivation.

2.11. National CPA Firm satisfies this objective by establishing and maintaining the following policies and procedures.

**2.12. Policy 1**

**Personnel who are hired will possess the appropriate characteristics to enable them to perform competently.**

2.13. National CPA Firm implements this policy by-

- a. Maintaining a national human resource function that establishes the firm's hiring objectives and evaluates the firm's personnel needs, including-
  - Designating a partner in its national office to be responsible for evaluating the firm's overall personnel needs and establishing hiring objectives based on factors such as clientele, anticipated growth, personnel turnover, and individual advancement.
  - Developing and maintaining a Human Resource Manual that identifies attributes, achievements, and experiences desired in entry-level and experienced personnel.
  - Establishing criteria to evaluate personal characteristics such as integrity, competence, and motivation.
  - Setting guidelines for additional procedures that are necessary when hiring experienced personnel, such as performing background checks and inquiring about any outstanding regulatory actions.
- b. Designating a qualified individual in each practice office to be responsible for managing the human resource function. This individual's responsibilities include-
  - Preparing budgets of personnel needs for all levels.
  - Identifying sources of employment candidates such as universities and executive recruiters, and coordinating the

**Guide for Establishing and Maintaining a System of Quality 10043  
Control for a CPA Firm's Accounting and Auditing Practice**

- hiring process within the practice office.
- Selecting and training those individuals who will be interviewing candidates or otherwise participating in the hiring process.
  - Summarizing and evaluating the results of the hiring process for each candidate and providing final approval for hiring.

**2.14. Policy 2**

**The firm will make personnel assignments based on the degree of technical training and proficiency required in the circumstances and the nature and extent of supervision to be provided.**

2.15. National CPA Firm implements this policy by designating an appropriate person in each office to be responsible for assigning personnel to engagements based on such factors as-

- Engagement size and complexity.
- Specialized experience or expertise required.
- Personnel availability and involvement of supervisory personnel.
- Timing of the work to be performed.
- Continuity and rotation of personnel.
- Opportunities for on-the-job training.
- Situations where independence or objectivity concerns exist.

For partner and manager assignments, such person shall be a partner, and in the case of high-risk engagements, approval of the partner assignment is to be obtained from the industry partner or the quality assurance partner.

**2.16. Policy 3**

**Personnel will participate in general and industry-specific continuing professional education and professional development activities that enable them to satisfy responsibilities assigned and fulfill applicable continuing professional education requirements of the AICPA and regulatory agencies.**

2.17. National CPA Firm implements this policy by-

- a. Maintaining a national professional development group to develop firm requirements and program materials for professional development and assigning responsibility for the professional development function to the Director of Professional Development. The groups responsibilities include-
  - Setting guidelines for participation by personnel in professional development programs and considering the requirements of the AICPA, state boards of accountancy, and regulatory agencies in establishing the firm's CPE



**10044 Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice**

- requirements.
  - Maintaining appropriate documentation evidencing that personnel have met the professional educational requirements of the firm, the AICPA, and other regulatory bodies.
  - Providing an orientation program and training for newly employed personnel to inform them of their professional responsibilities and the firm's policies.
  - Preparing publications and programs designed to inform personnel of their responsibilities and opportunities.
  - Developing in-house staff training programs that focus on general and industry-specific accounting and auditing subject matter.
- b. Assigning responsibility to an office or industry partner to establish a professional development program that provides that personnel in the office or those serving clients in an industry participate in professional development activities in accordance with firm guidelines and in subjects that are relevant to their responsibilities.
  - c. Communicating and distributing to personnel changes in accounting, auditing, and independence, integrity, and objectivity requirements and the firm's guidance with respect to them.
  - d. Encouraging participation in other professional development activities for personnel at each level within the firm, such as participation in external professional development programs, including graduate-level university and self-study courses, membership in professional organizations, serving on professional committees, and writing for professional publications.

**2.18. Policy 4**

**Personnel selected for advancement will have the qualifications necessary to fulfill the responsibilities they will be called on to assume.**

**2.19. National CPA Firm implements this policy by-**

- a. Maintaining a national human resource function to identify and communicate, in the firm's Human Resource Manual, the qualifications necessary to fulfill responsibilities at each professional level within the firm by-
  - (1) Establishing the criteria for evaluating personnel at each professional level and for advancement to the next higher level of responsibility.
  - (2) Developing evaluation forms for each professional staff classification.
- b. Assigning responsibility to a partner in each office for

**Guide for Establishing and Maintaining a System of Quality 10045  
Control for a CPA Firm's Accounting and Auditing Practice**

making advancement and termination decisions for staff and recommendations for manager- and partner-level advancements and terminations to the firm's management committee. Such responsibilities should include-

- (1) Identifying responsibilities and requirements for evaluations at each level indicating who will prepare the evaluations and when they will be prepared.
  - (2) Reviewing evaluations with the individual being evaluated on a timely basis.
- c. Counseling personnel regarding their progress and career opportunities by-
- (1) Annually summarizing and reviewing with personnel the evaluation of their performance, including an assessment of their progress with the firm. Considerations should include performance, future objectives of the firm and the individual, assignment preferences, and career opportunities.
  - (2) Annually evaluating partners by means of counseling, peer evaluation, or self-appraisal, as appropriate, regarding whether they continue to have the qualifications to fulfill their responsibilities or to assume added responsibilities.

**Acceptance and Continuance of Clients and Engagements**

2.20. The objective of the *Acceptance and Continuance of Clients and Engagements* element of a system of quality control is to establish criteria for deciding whether to accept or continue a client relationship and whether to perform a specific engagement for that client. Such policies and procedures should provide the firm with reasonable assurance that (a) the likelihood of association with a client whose management lacks integrity is minimized, (b) the firm undertakes only those engagements that can be completed with professional competence, (c) the risks associated with providing professional services in particular circumstances are appropriately considered, and (d) an understanding with the client regarding the services to be performed is reached.

2.21. National CPA Firm satisfies this objective, both with respect to the initial period for which the firm is performing its service and for subsequent periods, by establishing and maintaining the following policies and procedures.

**2.22. Policy 1**

**The firm will evaluate factors that have a bearing on managements integrity.**

**10046 Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice**

2.23. National CPA firm implements this policy by-

- a. Developing and maintaining a Professional Practice Manual that contains policies and procedures relating to the acceptance of prospective clients and the continuance of current clients. Such policies and procedures state that the firm's clients should not present undue risks to the firm, including damage to the firm's reputation.
- b. Advising personnel that they are expected to be familiar with the firm's policies and procedures for acceptance and continuance of clients.
- c. Obtaining and evaluating information before accepting or continuing a client, as applicable:
  - (1) Available information regarding the client and its operations from sources such as annual reports, interim financial statements, registration statements, Form 10-K, Form 8-K, other reports to regulatory agencies, enforcement actions by regulatory agencies, and income tax returns.
  - (2) The nature and purpose of the services to be provided by making inquiries of client management.
  - (3) Information regarding the client and its management and principals that may have a bearing on evaluating the client by making inquiries of third parties such as bankers, legal counsel, investment bankers, underwriters, and other members of the financial or business community who may have appropriate knowledge. Inquiries might also be made about managements attitude toward compliance with outside regulatory or legislative requirements and the presence of reportable conditions, especially those that management is unwilling to correct. In certain circumstances, background checks by investigative firms are required.
- d. Communicating with the predecessor accountant when required or suggested by professional standards. This communication also includes inquiries regarding the nature of any disagreements, and other events required to be reported by Form 8-K, and whether evidence of Aopinion shopping $\cong$  exists.
- e. Evaluating the information obtained regarding managements integrity.

**2.24. Policy 2**

**The firm will evaluate whether the engagement can be completed with professional competence and accordingly undertake only those engagements that can be completed with professional competence and appropriately consider the risk associated with providing professional services in particular circumstances.**

**Guide for Establishing and Maintaining a System of Quality 10047  
Control for a CPA Firm's Accounting and Auditing Practice**

2.25. National CPA Firm implements this policy by-

- a. Evaluating whether the practice office has obtained or can reasonably expect to obtain the knowledge and expertise necessary to enable it to perform the engagement, for example, through use of other practice offices' resources.
- b. Specifying conditions that require evaluation of a specific client or engagement, obtaining relevant information to determine whether the relationship should be continued, and establishing a time period for evaluations to be made (for example, continuance decisions should be made at least annually). Conditions include the following-
  - Significant changes in the client, for example, a major change in ownership, senior personnel, directors, advisors, the nature of its business, or its financial stability.
  - Changes in the nature or scope of the engagement, including requests for additional services.
  - Changes in the strategic focus or composition of the firm, for example, a decision to discontinue services to clients in a particular industry.
  - The existence of conditions that would have caused the firm to reject the engagement had such conditions existed at the time of the initial acceptance. These conditions may include unreliable processes for making accounting estimates, questionable estimates by management, questions regarding the entity's ability to continue as a going concern, or other factors that may increase the risk of being associated with the client.
  - Client delinquent in paying fees. (This may also affect the firm's independence.)
  - Engagements for entities operating in highly specialized or regulated industries, including financial institutions, governmental entities, and engagements for employee benefit plans.
  - Engagements for entities in the development stage.
- c. Evaluating the information obtained regarding the acceptance or continuance of the client or engagement.
  - (1) All information obtained about the client or the specific engagement is to be evaluated by the engagement partner and a recommendation is made regarding whether the client or engagement should be accepted or continued.
  - (2) The engagement partner completes a client acceptance form and submits it to the practice office managing partner for approval.
  - (3) The engagement partner signs a step in the planning program noting client continuance, and a form documenting client continuance is completed if conditions identified above (paragraph 2.25b) exist.

**10048 Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice**

- (4) The managing partner of the practice office is responsible for evaluating and approving the recommendation made by the engagement partner. In certain defined circumstances, such as new SEC engagements and high-risk engagements, documented acceptance may also require the approval of the national office.

**2.26. Policy 3**

**The firm will obtain an understanding with the client regarding the services to be performed.**

2.27. National CPA Firm implements this policy by requiring that all understandings with the client be in writing by obtaining an engagement letter for all engagements, thus minimizing the risk of misunderstandings regarding the nature, scope, and limitations of the services to be performed.

**Engagement Performance**

2.28. The objective of the *Engagement Performance* element of a system of quality control is to provide the firm with reasonable assurance that the work performed by engagement personnel meets the applicable professional standards, regulatory requirements, and the firm's standards of quality. Policies and procedures for engagement performance encompass all phases of the design and execution of the engagement. To the extent appropriate and as required by applicable professional standards, these policies and procedures should cover planning, performing, supervising, reviewing, documenting, and communicating the results of each engagement. Policies and procedures should also provide that personnel refer to authoritative literature or other sources and consult, on a timely basis, with individuals within or outside the firm, when appropriate.

2.29. National CPA Firm satisfies this objective by establishing and maintaining the following policies and procedures.

**2.30. Policy 1**

**Planning for engagements will meet professional, regulatory, and the firm's requirements.**

2.31. National CPA Firm implements this policy by developing, maintaining, and providing personnel with the firm's Professional Practice Manual, which prescribes the factors to be considered in the planning process by the engagement team and the extent of documentation of the considerations which may vary depending on the

**Guide for Establishing and Maintaining a System of Quality 10049  
Control for a CPA Firm's Accounting and Auditing Practice**

size and complexity of the engagement. Planning considerations include-

- Making the engagement partner or another qualified individual responsible for planning an engagement and assigning responsibilities to appropriate personnel during the planning phase.
- Developing or updating background information.
- Requiring planning documentation that includes-
  - Development of proposed work program, tailored to the specific engagement.
  - Staffing requirements and the need for specialized knowledge, which may have to be obtained from another practice office.
  - Considering economic conditions affecting the client or its industry and their potential impacts on the conduct of the engagement.
  - Considering risks and how they may affect the procedures to be performed.
  - Preparing a budget that allocates a sufficient amount of time so the engagement will be performed in accordance with professional standards and the firm's quality control policies and procedures.

**2.32. Policy 2**

**The engagement will be performed, supervised, reviewed, documented, and communicated in accordance with the requirements of professional standards, regulatory authorities, and the firm.**

**2.33. National CPA Firm implements this policy by-**

- a. Providing personnel with the firm's Professional Practice Manual, which
  - (1) Prescribes the form and content of working papers, including firm-generated forms, checklists, and questionnaires that are to be used in the performance of engagements, the form in which instructions are given to other offices or correspondents, and the extent to which their work is reviewed and documented.
  - (2) Specifies the extent of overall engagement review at all professional levels so that the financial statements meet professional and firm presentation and disclosure standards.
  - (3) Specifies the extent of review that should be performed of communications to be made to management and the board of directors.
- b. Assigning responsibility for the review of all reports, financial statements, and working papers to a reviewer senior to the preparer in accordance with procedures outlined in the

**10050 Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice**

firm's Professional Practice Manual to obtain reasonable assurance that-

- (1) The nature, timing, and extent of procedures performed are consistent with risk assessments made and the approach described in the planning documentation and that exceptions are appropriately investigated. The appropriateness of planned procedures should be reconsidered when significant changes in risk factors occur or are identified between the planning phase of the engagement and the execution of substantive procedures.
  - (2) Firm-prescribed forms, checklists, and questionnaires, tailored as appropriate, are used in the performance of the engagement and reporting on it.
- c. Requiring a second review of the report, financial statements, and selected working papers by a partner or manager as prescribed in the firm's Professional Practice Manual. The extent of review varies based on the type of engagement; for example, audits of SEC clients and high-risk engagements, as defined by the firm, receive the most extensive review.
- d. Adhering to the following guidelines set up by the firm regarding the review of working papers, financial statements, and for documentation of the review process:
- (1) All reviewers are to have appropriate experience, competence, and responsibility.
  - (2) All work performed and the reports and financial statements issued are to be complete and comply with professional standards and firm policy.
  - (3) Appropriate documentation is required on all engagements evidencing review of working papers, financial statements, and reports. Necessary documentation includes completion of the firm's review and approval documentation.
- e. Requiring that differences of professional judgment within an engagement team or with consultants be resolved with the assistance of the offices quality assurance partner and a designated partner in the firm's national office, where applicable. The resolution of the differences must be appropriately documented. If a member of the team continues to disagree with the resolution, he or she may disassociate himself or herself from the resolution of the matter and will be offered the opportunity to document that a disagreement still exists.

**2.34. Policy 3**

**The firm will identify areas and specialized situations where consultation is required and will require personnel to refer to authoritative literature and practice aids and to consult, on a**

**Guide for Establishing and Maintaining a System of Quality 10051  
Control for a CPA Firm's Accounting and Auditing Practice**

timely basis, with individuals within or outside the firm when appropriate (for example, when dealing with complex, unusual, or unfamiliar issues).

2.35. National CPA Firm implements this policy by-

- a. Providing personnel with the firm's Professional Practice Manual, which specifies the firm's consultation policies and procedures. Areas or specialized situations that may require consultation include-
  - Application of newly issued technical pronouncements.
  - Industries with special accounting, auditing, or reporting requirements.
  - Emerging practice problems.
  - Choices among alternative generally accepted accounting principles upon initial adoption or when an accounting change is made.
  - Reissuance of a report, consideration of omitted procedures after a report has been issued, or subsequent discovery of facts that existed at the time a report was issued.
  - Filing requirements of regulatory agencies.
  - Meetings with the SEC and other regulators, at which the firm is to be called on to support the applications of generally accepted accounting principles which have been questioned.
- b. Designating individuals within the firm as consultants in certain areas. Personnel are to consult with the appropriate individual when issues arise, as specified in the firm's manuals. When differences arise between the engagement partner and the consultant, all resolutions are determined by the office quality assurance partner and, if it continues to be unresolved, a designated national office partner.
- c. Maintaining or providing access to adequate and up-to-date reference libraries in each office, which include materials related to specific industries and regulatory requirements.
- d. Requiring that documentation of consultation include all relevant facts and circumstances, reference to professional literature used in the determination, the conclusions reached, and signatures of the engagement partner and consultant. This documentation is to be retained in the engagement working papers and, at the discretion of the consultant, entered in a retrievable database to promote consistency in the application of generally accepted accounting principles in similar circumstances.

**Monitoring**

2.36. The objective of the *Monitoring* element of a system of



**10052 Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice**

quality control is to provide the firm with reasonable assurance that the policies and procedures relating to the other elements of quality control are suitably designed and being effectively applied. Monitoring is an ongoing consideration and evaluation process.

2.37. National CPA Firm satisfies this objective by establishing and maintaining the following policies and procedures.

**2.38. Policy 1**

The firm will consider and evaluate, on an ongoing basis, the relevance and adequacy of its quality control policies and procedures.

2.39. National CPA Firm implements this policy by designating a partner or group in its national office to be responsible for quality assurance, including-

- a. Assuring that the firm's quality control policies and procedures and its audit methodology remain relevant and adequate. Factors to be considered include-
  - Mergers and divestitures of portions of the practice.
  - Changes in professional standards and SEC or other regulatory requirements applicable to the firm's practice.
  - Results of annual inspections and peer reviews.
  - Review of litigation and regulatory enforcement actions against the firm and others.
  - The impact that changes in technology may have on clients' methods of doing business.
  - Changes in clients' industries that impact their operations.
  - Changes in applicable AICPA membership requirements.
- b. Determining whether personnel have been appropriately informed of their responsibilities for maintaining the firm's standards of quality in performing their duties.
- c. Identifying the need to-
  - (1) Revise policies and procedures related to the other elements of quality control because they are ineffective or inappropriately designed.
  - (2) Improve compliance with firm policies and procedures that are related to the other elements of quality control.

**2.40. Policy 2**

The firm will consider and evaluate, on an ongoing basis, the appropriateness of its guidance materials and any practice aids.

**Guide for Establishing and Maintaining a System of Quality 10053  
Control for a CPA Firm's Accounting and Auditing Practice**

2.41. National CPA Firm implements this policy by-

- a. Reviewing and updating firm practice aids, such as audit programs, forms, and checklists, based on the issuance of new professional pronouncements.
- b. Issuing professional practice alerts to notify and provide guidance to personnel regarding new professional standards, regulatory requirements, and related changes to firm policy.
- c. Having national office personnel periodically visit offices and interview partners and managers regarding the effectiveness of practice aids and tools.

2.42. Policy 3

**The firm will consider and evaluate, on an ongoing basis, the effectiveness of professional development programs.**

2.43. National CPA Firm implements this policy by-

- a. Having the National Professional Development Group review the summary of evaluations of national training programs to determine whether the national professional development programs are achieving their objectives.
- b. Having the National Professional Development Group review the overall professional development plan to determine whether professional staff are receiving the appropriate mix of in-house training, AICPA or state society classroom training, and self-study programs.
- c. Having the National Professional Development Group review summaries of CPE records for the firm's professional staff to determine that each practice office has established a means of tracking each professional's compliance with the requirements of the firm, the AICPA, and other regulatory bodies.
- d. Interviewing selected professional personnel regarding the effectiveness of training programs.
- e. Considering the results of the firm's inspection procedures in connection with the effectiveness of the firm's professional development program.
- f. Ascertaining whether inquiries received by individuals consulted within the firm indicate the need for additional CPE programs.

2.44. Policy 4

**The firm will consider and evaluate, on an ongoing basis, compliance with its policies and procedures.**

2.45. National CPA Firm implements this policy by making its national quality assurance partner responsible for the preparation of checklists and practice aids to be used in performing monitoring

**10054 Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice**

and inspection procedures. These procedures include-

- Developing and coordinating the firm's inspection program to achieve feedback about the effectiveness of the firm's policies and procedures.
- Developing a plan for an appropriate test of compliance with the firm's policies and procedures on a sample of engagements. Such a review could be preissuance or postissuance.
- Reviewing correspondence prepared by national office personnel regarding consultation on independence, integrity, and objectivity matters, acceptance and continuance decisions, and engagement performance.
- Reviewing the resolution of matters reported by professional personnel on independence circularization forms to determine that matters have been appropriately considered and resolved.
- Interviewing personnel at all professional management and staff levels to obtain information regarding operating procedures in practice offices and to determine whether personnel are knowledgeable of firm policies and procedures and whether they are being effectively communicated.
- Reviewing the following documentation to determine compliance with firm policies and procedures:
  - a. Personnel evaluations, including documentation of hiring and advancement decisions
  - b. Documentation of client acceptance and continuance decisions
  - c. Participants' evaluations of training programs
  - d. Professional development records of professional personnel
  - e. Correspondence regarding the resolution of independence matters within the practice office
- Reviewing a cross-section of engagements that have had a preissuance or postissuance review from selected practice offices using the following criteria:
  - a. All partners and those managers who have significant accounting and auditing responsibilities in the selected offices
  - b. Significant specialized industries with emphasis given to high-risk industries
  - c. First-year engagements
  - d. Level of service performed (that is, audit, review, compilation, and agreed-upon procedures)
  - e. Level of attestation services performed (that is, examination, review, and agreed-upon procedures)
- Periodically summarizing and communicating inspection findings to firm personnel on a timely basis.
- Communicating findings to practice office personnel and determining the corrective actions to be taken on the engagements reviewed. These findings are discussed and

**Guide for Establishing and Maintaining a System of Quality 10055  
Control for a CPA Firm's Accounting and Auditing Practice**

communicated in a report issued to each office. The practice office responds regarding the specific corrective actions or steps to be taken to improve compliance with the firm's policies and procedures and professional standards.

- Communicating the need for improved compliance with or changes to the system of quality control in training programs, partner or manager meetings, and firm policy correspondence.
- Preparing a summary inspection report that evaluates the overall results of the inspection to determine whether-
  - a. The firm as a whole needs to improve compliance with the firm's policies and procedures.
  - b. Revisions to the firm's quality control policies and procedures are necessary.
- Periodically reviewing the system of personnel evaluation and counseling to ascertain that-
  - a. Procedures for evaluation and documentation are being followed on a timely basis.
  - b. Requirements established for advancement are being achieved.
  - c. Personnel decisions are consistent with evaluations.
  - d. Recognition is given to outstanding performance.

10056 Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice

Chapter 3

Regional Accountants' System of Quality Control for Its Accounting and Auditing Practice

3.01. This chapter describes how Regional Accountants implements each element of quality control for its accounting and auditing practice. Regional Accountants is a hypothetical firm. It is presumed to have ten offices in three states and to be centrally managed. Regional has thirty-five partners, two hundred professionals and twenty-five SEC clients. In addition to servicing SEC clients, it has a concentration in audit and attest services for financial institutions.

Independence, Integrity, and Objectivity

3.02. The objective of the *Independence, Integrity, and Objectivity* element of a system of quality control is to provide the firm with reasonable assurance that personnel maintain independence (in fact and in appearance) in all required circumstances, perform all professional responsibilities with integrity, and maintain objectivity in discharging professional responsibilities.

3.03. Regional Accountants satisfies this objective by establishing and maintaining the following policies and procedures.

3.04. Policy 1

Personnel will adhere to applicable independence, integrity, and objectivity requirements. These requirements include regulations, interpretations, and rulings of the AICPA, state CPA societies, state boards of accountancy, state statutes, the Securities and Exchange Commission, and other regulatory agencies where applicable.

3.05. Regional Accountants implements this policy By-

- a. Developing and maintaining a manual that contains the firm's policies and procedures relating to independence, objectivity, and integrity. Such policies and procedures contain the firm's interpretations of professional and regulatory requirements, and guidance for identifying and resolving potential issues or situations.
- b. Designating one of its partners to provide guidance, answer questions and resolve matters, and determine the circumstances that might require consultation with sources outside the firm.
- c. Identifying circumstances where documentation of the resolution of matters is appropriate.
- d. Obtaining written representations from personnel, upon hire

**Guide for Establishing and Maintaining a System of Quality 10057  
Control for a CPA Firm's Accounting and Auditing Practice**

and on an annual basis, stating whether they are familiar with and are in compliance with professional standards and the firm's policies and procedures regarding independence, integrity, and objectivity.

- e. Assigning responsibility for obtaining such representations, reviewing compliance files for completeness, and resolving reported exceptions to the firm's quality control partner.
- f. Requiring the managing partner in each office to periodically review unpaid fees from clients to ascertain whether any outstanding amounts impair the firm's independence.

**3.06. Policy 2**

**Personnel will be familiar with policies and procedures relating to independence, integrity, and objectivity.**

3.07. Regional Accountants implements this policy By-

- a. Providing personnel with access to a computer and software that has access to databases containing professional and regulatory literature and advising them that they are expected to be familiar with that literature.
- b. Emphasizing the concepts of independence, integrity, and objectivity in its professional development meetings, in the acceptance and continuance of clients and engagements, and in the performance of engagements, including discussing the implications regarding engagements for financial institutions, such as the prohibition of any member of the engagement team having a loan with the institution, and the types of nonattest services that could affect independence.
- c. Informing personnel on a timely basis of those entities to which independence policies apply, By-
  - (1) Preparing and maintaining lists of entities to which independence policies apply.
  - (2) Making the lists available to personnel who need them to determine their independence (including personnel new to the firm or to an office, and certain former partners<sup>1</sup>).
  - (3) Notifying personnel of changes in the lists on a timely basis via a memorandum or the firm's E-mail system.

**3.08. Policy 3**

**Confirm the independence of another firm performing parts of an engagement, or when we act as principal auditor.**

---

<sup>1</sup> AICPA's *Professional Standards*, vol. 2, ET sec. 101.04, discusses circumstances when activities of a former practitioner could affect the firm's independence.

**10058 Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice**

3.09. Regional Accountants implements this policy By-

- a. Describing in its policies and procedures manual the form, content, and frequency of independence representations that are to be obtained.
- b. Requiring that such representations be documented.

**Personnel Management**

3.10. The objective of the *Personnel Management* element of a system of quality control is to provide the firm with reasonable assurance that all personnel have the proficiency to perform their assigned responsibilities. Attributes or qualities that enhance the proficiency of personnel who perform, supervise, or review work include integrity, objectivity, intelligence, judgment, competence, experience, and motivation.

3.11. Regional Accountants satisfies this objective by establishing and maintaining the following policies and procedures.

**3.12. Policy 1**

**Personnel who are hired will possess the appropriate characteristics to enable them to perform competently.**

3.13. Regional Accountants implements this policy by maintaining firm-wide hiring objectives and evaluating the firm's personnel needs, including-

- Designating a partner or a qualified individual in each office to be responsible for evaluating that practice offices overall personnel needs and establishing hiring objectives based on factors such as clientele, anticipated growth, personnel turnover, and individual advancement.
- Developing and maintaining personnel policies and procedures that identify attributes, achievements, and experiences desired in entry-level and experienced personnel.
- Establishing criteria to evaluate personal characteristics such as integrity, competence, and motivation.
- Setting guidelines as to additional procedures that are necessary when hiring experienced personnel, such as performing background checks and inquiring about any outstanding regulatory actions.
- Identifying sources of employment candidates such as universities and executive recruiters, and coordinating the hiring process within the practice office.
- Selecting and training the individuals who will be interviewing candidates or otherwise participating in the hiring process.

**Guide for Establishing and Maintaining a System of Quality 10059  
Control for a CPA Firm's Accounting and Auditing Practice**

- Summarizing and evaluating the results of the hiring process for each candidate and providing final approval for hiring.

**3.14. Policy 2**

**The firm will make personnel assignments based on the degree of technical training and proficiency required in the circumstances and the nature and extent of supervision to be provided.**

**3.15. Regional Accountants implements this policy by-**

- a. Designating an appropriate person in each office to be responsible for assigning personnel to engagements based on such factors as-
  - Engagement size and complexity.
  - Specialized experience and expertise required.
  - Personnel availability and involvement of supervisory personnel.
  - Timing of the work to be performed.
  - Continuity and rotation of personnel.
  - Opportunities for on-the-job training.
  - Situations where independence or objectivity concerns exist.
- b. Designating the quality control partner as the person responsible for approval of the partner assignments on high-risk engagements.

**3.16. Policy 3**

**Personnel will participate in general and industry-specific continuing professional education and professional development activities that enable them to satisfy responsibilities assigned and fulfill applicable continuing professional education requirements of the AICPA and regulatory agencies.**

**3.17. Regional Accountants implements this policy by-**

- a. Designating one partner responsible for developing firm requirements and program materials for professional development. These responsibilities include-
  - Setting guidelines for participation by personnel in professional development programs, and considering requirements of the AICPA, state boards of accountancy, and regulatory agencies in establishing the firm's CPE requirements.
  - Maintaining appropriate documentation evidencing that personnel have met the professional education requirements of the firm, the AICPA, and other regulatory bodies.
  - Providing an orientation program and training for newly



**10060 Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice**

employed personnel to inform them of their professional responsibilities and firm policies.

- Preparing publications and programs designed to inform personnel of their responsibilities and opportunities.
  - Developing in-house staff training programs that focus on general and industry-specific accounting and auditing subject matter, including audits of financial institutions.
- b. Assigning responsibility to an office or industry partner to maintain a professional development program that provides that personnel in the office or those serving clients in an industry participate in professional development activities in accordance with firm guidelines and in subjects that are relevant to their responsibilities.
- c. Communicating and distributing to personnel changes in accounting, auditing, and independence, integrity, and objectivity requirements and the firm's guidance with respect to them.
- d. Encouraging participation in other professional development activities for personnel at each level within the firm, such as participation in external professional development programs, including graduate level and self-study courses, membership in professional organizations, serving on professional committees, and writing for professional publications.

**3.18. Policy 4**

**Personnel selected for advancement will have the qualifications necessary to fulfill the responsibilities they will be called on to assume.**

**3.19. Regional Accountants implements this policy by-**

- a. Appointing a Director of Human Resources to identify and communicate in the firm's policies and procedures manual the qualifications necessary to fulfill responsibilities at each professional level within the firm by-
- (1) Establishing the criteria for evaluating personnel at each professional level and for advancement to the next higher level of responsibility.
  - (2) Developing evaluation forms for each professional staff classification.
- b. Assigning responsibility to one of its partners for making advancement and termination decisions for staff and recommendations for manager- and partner-level advancements and terminations to the firm's management committee. Such responsibilities should include-
- (1) Identifying responsibilities and requirements for

**Guide for Establishing and Maintaining a System of Quality 10061  
Control for a CPA Firm's Accounting and Auditing Practice**

- evaluation at each level and indicating who will prepare evaluations and when they will be prepared.
- (2) Reviewing evaluations with the individual being evaluated on a timely basis.
- c. Counseling personnel regarding their progress and career opportunities by-
- (1) Annually summarizing and reviewing with personnel the evaluation of their performance, including an assessment of their progress with the firm. Considerations should include performance, future objectives of the firm and the individual, assignment preferences, and career opportunities.
  - (2) Periodically evaluating partners by means of counseling, peer evaluation, or self-appraisal, as appropriate, regarding whether they continue to have the qualifications to fulfill their responsibilities or assume added responsibilities.

**Acceptance and Continuance of Clients and Engagements**

3.20. The objective of the *Acceptance and Continuance of Clients and Engagements* element of a system of quality control is to establish criteria for deciding whether to accept or continue a client relationship and whether to perform a specific engagement for that client. Such policies and procedures should provide the firm with reasonable assurance that (a) the likelihood of associations with a client whose management lacks integrity is minimized, (b) the firm undertakes only those engagements that can be completed with professional competence, (c) the risks associated with providing professional services in particular circumstances are appropriately considered, and (d) an understanding with the client regarding the services to be performed is reached.

3.21. Regional Accountants satisfies this objective, both with respect to the initial period for which the firm is performing its service and for subsequent periods, by establishing and maintaining the following policies and procedures.

**3.22. Policy 1**

**The firm will evaluate factors that have a bearing on managements integrity.**

3.23. Regional Accountants implements this policy by-

- a. Developing and maintaining a policies and procedures manual that contains policies and procedures relating to acceptance of prospective clients and the continuance of current clients. Such policies and procedures state that the firm's clients

**10062 Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice**

- should not present undue risks to the firm, including damage to the firm's reputation.
- b. Advising personnel that they are expected to be familiar with the firm's policies and procedures for acceptance and continuance of clients.
  - c. Obtaining and evaluating information before accepting or continuing a client, as applicable—
    - (1) Available information regarding the client and its operations from sources such as annual reports, interim financial statements, registration statements, Form 10-K, Form 8-K, other reports to regulatory agencies, enforcement actions by regulatory agencies, and income tax returns.
    - (2) The nature and purpose of the services to be provided by making inquiries of client management.
    - (3) Information regarding the client and its management and principals that may have a bearing on evaluating the client by making inquiries of third parties such as bankers, legal counsel, investment bankers, underwriters, and other members of the financial or business community who may have appropriate knowledge. Inquiries might also be made about managements attitude toward compliance with outside regulatory or legislative requirements and the presence of reportable conditions, especially those that management is unwilling to correct. In certain circumstances, background checks by investigative firms are required.
  - d. Communicating with the predecessor accountant when required or suggested by professional standards. This communication also includes inquiries regarding the nature of any disagreements and other events required to be reported by Form 8-K, and whether evidence of Aopinion shopping<sup>≅</sup> exists.
  - e. Evaluating the information obtained regarding managements integrity.

**3.24. Policy 2**

**The firm will evaluate whether the engagement can be completed with professional competence and accordingly undertake only those engagements that can be completed with professional competence and appropriately consider the risk associated with providing professional services in particular circumstances.**

**3.25. Regional Accountants implements this policy by—**

- a. Evaluating whether the practice office has obtained or can reasonably expect to obtain the knowledge and expertise necessary to enable it to perform the engagement, for example, through the use of another practice office's resources.

**Guide for Establishing and Maintaining a System of Quality 10063  
Control for a CPA Firm's Accounting and Auditing Practice**

- b. Specifying conditions that require evaluation of a specific client or engagement, obtaining relevant information to determine whether the relationship should be continued, and establishing a time period for evaluations to be made (for example, continuance decisions should be made at least annually). Conditions include the following:
- Significant changes in the client, for example, a major change in ownership, senior client personnel, directors, advisors, the nature of its business, or its financial stability.
  - Changes in the nature or scope of the engagement, including requests for additional services.
  - Changes in the strategic focus or composition of the firm, for example, the inability to replace the loss of key personnel who are particularly knowledgeable about a specialized industry, or the decision to discontinue services to clients in a particular industry.
  - The existence of conditions that would have caused the firm to reject the engagement had such conditions existed at the time of the initial acceptance. These conditions may include unreliable processes for making accounting estimates, questionable estimates by management, questions regarding the entity's ability to continue as a going concern, and other factors that may increase the risk of being associated with the client.
  - Client delinquent in paying fees. (This may also affect the firm's independence.)
  - Engagements for entities operating in highly specialized or regulated industries, including financial institutions and governmental entities, and engagements for employee benefit plans.
  - Engagements for entities in the development stage.
- c. Evaluating the information obtained regarding the acceptance or continuance of the client or engagement.
- (1) All information obtained about the client or the specific engagement is evaluated by the engagement partner and a recommendation is made regarding whether the client or engagement should be accepted or continued.
  - (2) The engagement partner completes a client acceptance form and submits it to the practice office managing partner for approval.
  - (3) The engagement partner signs a step in the planning program noting client continuance, and a form documenting client continuance is completed if conditions identified above (paragraph 3.25b) exist.
  - (4) The firm's quality control partner is responsible for evaluating and approving the recommendation made by the engagement partner. In certain defined circumstances,

**10064 Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice**

such as new SEC engagements or high-risk engagements, documented acceptance or continuance decisions may also require the approval of the firm's managing partner.

**3.26. Policy 3**

**The firm will obtain an understanding with the client regarding the services to be performed.**

3.27. Regional Accountants implements this policy by requiring that all understandings with the client be in writing by obtaining an engagement letter for all engagements, thus minimizing the risk of misunderstandings regarding the nature, scope, and limitations of the services to be performed.

**Engagement Performance**

3.28. The objective of the *Engagement Performance* element of a system of quality control is to provide the firm with reasonable assurance that the work performed by engagement personnel meets the applicable professional standards, regulatory requirements, and the firm's standards of quality. Policies and procedures for engagement performance encompass all phases of the design and execution of the engagement. To the extent appropriate and as required by applicable professional standards, these policies and procedures should cover planning, performing, supervising, reviewing, documenting, and communicating the results of each engagement. Policies and procedures should also provide that personnel refer to authoritative literature or other sources and consult, on a timely basis, with individuals within or outside the firm when appropriate (for example, when dealing with complex, unusual, or unfamiliar issues).

3.29. Regional Accountants satisfies this objective by establishing and maintaining the following policies and procedures.

**3.30. Policy 1**

**Planning for engagements will meet professional, regulatory, and the firm's requirements.**

3.31. Regional Accountants implements this policy by developing, maintaining, and providing personnel with the firm's policies and procedures manual which prescribes the factors to be considered in the planning process by the engagement team and the extent of documentation of the considerations which may vary depending on the size and complexity of the engagement. Planning considerations include-

**Guide for Establishing and Maintaining a System of Quality 10065  
Control for a CPA Firm's Accounting and Auditing Practice**

- Making the engagement partner responsible for planning an engagement and assigning responsibilities to appropriate personnel during the planning phase.
- Developing or updating background information.
- Requiring planning documentation that includes—
  - Development of proposed work program, tailored to the specific engagement.
  - Staffing requirements and the need for specialized knowledge, which may have to be obtained from another practice office.
  - Considering the economic conditions affecting the client or its industry and their potential impacts on the conduct of the engagement.
  - Considering the risks and how they may affect the procedures to be performed.
  - Preparing a budget that allocates a sufficient amount of time so the engagement will be performed in accordance with professional standards and the firm's quality control policies and procedures.

**3.32. Policy 2**

**The engagement will be performed, supervised, reviewed, documented, and communicated in accordance with the requirements of professional standards, regulatory authorities, and the firm.**

**3.33. Regional Accountants implements this policy by—**

- a. Providing personnel with the firm's policies and procedures manual, which—
  - (1) Prescribes the form and content of working papers, including firm-generated or purchased forms, checklists, questionnaires that are to be used in the performance of engagements, the form in which instructions are given to other offices or correspondents, and the extent to which their work is reviewed and documented.
  - (2) Specifies the extent of overall engagement review, at all professional levels, so the financial statements meet professional and firm presentation and disclosure standards.
  - (3) Specifies the extent of review that should be performed of communications to be made to management and the board of directors.
- b. Assigning responsibility for the review of all reports, financial statements, and working papers to a reviewer senior to the preparer in accordance with procedures outlined in the firm's manual to obtain reasonable assurance that—
  - (1) The nature, timing, and extent of procedures performed are consistent with risk assessments made and the

**10066 Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice**

- approach described in the planning documentation and that exceptions are appropriately investigated. The appropriateness of planned procedures should be reconsidered when significant changes in risk factors occur or are identified between the planning phase of the engagement and the execution of substantive procedures.
- (2) Firm-prescribed forms, checklists, and questionnaires, tailored as appropriate, are used in the performance of the engagement and reporting on it.
- c. Requiring a second review of the report, financial statements, and selected working papers by a partner or manager as prescribed in the firm's policies and procedures manual. The extent of review varies based on the type of engagement; for example, audits of SEC clients, engagements for financial institutions and high-risk engagements, as defined by the firm, receive the most extensive review.
  - d. Adhering to guidelines set up by the firm regarding the review of working papers, financial statements, and for documentation of the review process--
    - (1) All reviewers are to have appropriate experience, competence and responsibility.
    - (2) All work performed and the reports and financial statements issued are to be complete and comply with professional standards and firm policy.
    - (3) Appropriate documentation is required on all engagements evidencing review of working papers, financial statements, and reports. Necessary documentation includes completion of the firm's review and approval documentation.
  - e. Requiring that all differences of professional judgment within an engagement team be resolved by the engagement and quality control partner. The resolution of the differences must be appropriately documented. If a member of the engagement team continues to disagree with the resolution, he or she may disassociate himself or herself from the resolution of the matter and will be offered the opportunity to document that a disagreement still exists.

**3.34. Policy 3**

The firm will identify areas and specialized situations where consultation is required and will require personnel to refer to authoritative literature and practice aids and to consult, on a timely basis, with individuals within or outside the firm when appropriate (for example, when dealing with complex, unusual, or unfamiliar issues).

3.35. Regional Accountants implements this policy by-

**Guide for Establishing and Maintaining a System of Quality 10067  
Control for a CPA Firm's Accounting and Auditing Practice**

- a. Providing personnel with the firm's policies and procedures manual, which specifies the firm's consultation policies and procedures. Areas or specialized situations that may require consultation include-
  - Application of newly issued technical pronouncements.
  - Industries with special accounting, auditing, or reporting requirements.
  - Emerging practice problems.
  - Choices among alternative generally accepted accounting principles upon initial adoption or when an accounting change is made.
  - Reissuance of a report, consideration of omitted procedures after a report has been issued or subsequent discovery of facts that existed at the time a report was issued.
  - Filing requirements of regulatory agencies.
  - Meetings with the SEC and other regulators at which the firm is to be called upon to support the application of generally accepted accounting principles which have been questioned.
- b. Designating individuals within the firm as consultants in certain areas. Personnel are to consult with the appropriate individual when issues arise. When differences arise between the engagement partner and the consultant, the matter is resolved by the firm's quality control partner.
- c. Maintaining or providing access to adequate and up-to-date reference libraries in each office which include materials related to specific industries, specialties, and regulatory requirements.
- d. Requiring that documentation of consultation include all relevant facts and circumstances, reference to professional literature used in the determination, the conclusion reached, and signatures of the engagement partner and consultant. This documentation is to be retained in the engagement working papers, and at the discretion of the consultant, entered in a retrievable database to promote consistency in the application of generally accepted accounting principles in similar circumstances.

**Monitoring**

3.36. The objective of the *Monitoring* element of a system of quality control is to provide the firm with reasonable assurance that the policies and procedures relating to the other elements of quality control are suitably designed and being effectively applied. Monitoring is an ongoing consideration and evaluation process.



**10068 Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice**

3.37. Regional Accountants satisfies this objective by establishing and maintaining the following policies and procedures.

**3.38. Policy 1**

**The firm will consider and evaluate, on an ongoing basis, the relevance and adequacy of its quality control policies and procedures.**

3.39. Regional Accountants implements this policy by designating a partner or a management-level individual with appropriate authority to be responsible for quality assurance, including-

- a. Assuring that the firm's quality control policies and procedures and its audit methodology remain relevant and adequate. Factors to be considered include-
  - Mergers and divestitures of portions of the practice.
  - Changes in professional standards, and SEC or other regulatory requirements applicable to the firm's practice.
  - Results of annual inspections and peer reviews.
  - Review of litigation and regulatory enforcement actions against the firm and others.
  - Impact that changes in technology may have on clients' methods of doing business.
  - Changes in clients' industries that impact their operations.
  - Changes in applicable AICPA membership requirements.
- b. Determining whether personnel have been appropriately informed of their responsibilities for maintaining the firm's standards of quality in performing their duties.
- c. Identifying the need to-
  - (1) Revise policies and procedures related to the other elements of quality control because they are ineffective or inappropriately designed.
  - (2) Improve compliance with firm policies and procedures that are related to the other elements of quality control.

**3.40. Policy 2**

**The firm will consider and evaluate, on an ongoing basis, the appropriateness of its guidance materials and any practice aids.**

3.41. Regional Accountants implements this policy by-

- a. Reviewing and updating firm practice aids, such as audit programs, forms, and checklists, based on the issuance of new professional pronouncements.
- b. Issuing guidance regarding new professional standards, regulatory requirements, and related changes to firm policy.

**Guide for Establishing and Maintaining a System of Quality 10069  
Control for a CPA Firm's Accounting and Auditing Practice**

- c. Soliciting comments from partners and managers as to the effectiveness of practice aids and tools.

**3.42. Policy 3**

**The firm will consider and evaluate, on an ongoing basis, the effectiveness of professional development programs.**

3.43. Regional Accountants implements this policy by-

- a. Designating a partner or qualified individual in each office to review the summary of evaluations of in-house training programs to determine whether the programs are achieving their objectives.
- b. Designating a partner or qualified individual in each office to review summaries of CPE records for that offices professional staff to determine that the office has established a means of tracking each individual's compliance with the requirements of the AICPA and other regulatory bodies.
- c. Interviewing selected professional personnel regarding the effectiveness of training programs.
- d. Considering the results of the firm's inspection in connection with the effectiveness of the firm's professional development program.
- e. Ascertaining whether inquiries received by individuals consulted within the firm indicate the need for additional CPE programs.

**3.44. Policy 4**

**The firm will consider and evaluate, on an ongoing basis, compliance with its policies and procedures.**

3.45. Regional Accountants implements this policy by making its quality control partner responsible for preparing inspection checklists and guidance materials, or using materials prepared by the AICPA for performing inspection procedures. These procedures include-

- Developing and coordinating the firm's inspection program to achieve feedback about the effectiveness of the firm's policies and procedures.
- Developing a plan for an appropriate test of compliance with the firm's policies and procedures on a sample of engagements. Such a review could be preissuance or postissuance.
- Reviewing the resolution of matters reported by professional personnel on independence circularization forms to determine that matters have been appropriately considered and resolved.
- Interviewing personnel at all professional management and

**10070 Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice**

- staff levels to obtain information regarding operating procedures in practice offices and to determine whether personnel are knowledgeable of firm policies and procedures and whether they are being effectively communicated.
- Reviewing the following documentation to determine compliance with firm policies and procedures—
    - a. Personnel evaluations, including documentation of hiring and advancement decisions
    - b. Documentation of client acceptance and continuance decisions
    - c. Participants' evaluations of practice office training programs
    - d. Professional development records of personnel
    - e. Correspondence regarding the resolution of independence matters within the practice office
  - Reviewing a cross-section of engagements from selected practice offices using the following criteria—
    - a. All partners and managers who have significant accounting and auditing responsibilities in the selected offices
    - b. Engagements for financial institutions
    - c. First-year engagements
    - d. Significant specialized industries with emphasis given to high-risk industries
    - e. Level of service performed (that is, audit, review, compilation, and attestation)
    - f. Level of attestation services performed (that is, examination, review, and agreed-upon procedures)
  - Summarizing findings resulting from the inspection procedures.
  - Communicating findings to practice office personnel and determining the corrective actions to be taken on the engagements reviewed. These findings are discussed and communicated in a report issued to each office. The practice office responds regarding the specific corrective actions or steps to be taken to improve compliance with the firm's policies and procedures and professional standards.
  - Preparing a summary inspection report to the firm's senior management that evaluates the overall results of the inspection to determine whether—
    - a. The firm as a whole needs to improve compliance with the firm's policies and procedures.
    - b. Revisions to the firm's quality control policies and procedures are necessary.
  - Communicating the need for improved compliance with or changes to the system of quality control in training programs, partner manager meetings, and firm policy correspondence.
  - Periodically reviewing the system of personnel evaluation and counseling to ascertain that—
    - a. Procedures for evaluation and documentation are being

**Guide for Establishing and Maintaining a System of Quality 10071  
Control for a CPA Firm's Accounting and Auditing Practice**

- followed on a timely basis.
- b. Requirements established for advancement are being achieved.
  - c. Personnel decisions are consistent with evaluations.
  - d. Recognition is given to outstanding performance.

10072 Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice

Chapter 4

AnyCity CPAs' System of Quality Control for Its Accounting and Auditing Practice

4.01. This chapter describes how AnyCity CPAs implements each element of quality control for its accounting and auditing practice. AnyCity CPAs is a hypothetical firm. It is presumed to be a local, one-office firm with three partners and a total of ten professionals. Its accounting and auditing practice has a concentration of five employee benefit plan audits. AnyCity CPAs has no SEC clients. The firm uses purchased practice aids that have been subjected to peer review in accordance with standards established by the AICPA. These practice aids are supplemented by oral and written communications from the firm's partners. To enhance communications, the firm has chosen to provide its personnel with a written summary of its quality control policies and procedures that contains statements incorporated by reference to policies and procedures from its purchased practice aids, tailored to the specific needs of its practice.

**Independence, Integrity, and Objectivity**

4.02. The objective of the *Independence, Integrity, and Objectivity* element of a system of quality control is to provide the firm with reasonable assurance that personnel maintain independence (in fact and in appearance) in all required circumstances, perform all professional responsibilities with integrity, and maintain objectivity in discharging professional responsibilities.

4.03. AnyCity CPAs satisfies this objective by establishing and maintaining the following policies and procedures.

4.04. Policy 1

Personnel will adhere to applicable independence, integrity, and objectivity requirements. These requirements include regulations, interpretations, and rulings of the AICPA, state CPA societies, state boards of accountancy, state statutes, and other regulatory agencies where applicable.

4.05. AnyCity CPAs implements this policy by-

- a. Designating a partner to provide guidance, answer questions, and resolve matters.
- b. Identifying circumstances where documentation of the resolution of matters is appropriate.
- c. Obtaining written representations from personnel, upon hire and on an annual basis, stating whether they are familiar with

**Guide for Establishing and Maintaining a System of Quality 10073  
Control for a CPA Firm's Accounting and Auditing Practice**

and are in compliance with professional standards and the firm's policies and procedures regarding independence, integrity, and objectivity.

- d. Assigning responsibility for obtaining representations, reviewing compliance files for completeness, and resolving reported exceptions to a partner.
- e. Having a partner periodically review unpaid fees from clients to ascertain whether any outstanding amounts impair the firm's independence.

**4.06. Policy 2**

**Personnel will be familiar with policies and procedures relating to independence, integrity, and objectivity.**

**4.07. AnyCity CPAs implements this policy by-**

- a. Subscribing to and updating the AICPA *Professional Standards* loose-leaf service and other services pertaining to its practice, including a service that contains the Department of Labor's rules and regulations, and making these available in its office library.
- b. Emphasizing the concepts of independence, integrity, and objectivity during its staff meetings, in the acceptance and continuance of clients and engagements, and in the performance of engagements, including discussing implications of auditing employee benefit plans and the types of nonattest services that could affect independence.
- c. Informing personnel on a timely basis of those entities to which independence policies apply, by-
  - (1) Preparing and maintaining a list of entities to which independence applies.
  - (2) Making the list available to personnel who need it to determine their independence (including personnel new to the firm and certain former partners<sup>1</sup>).
  - (3) Notifying personnel of changes in the list on a timely basis via memorandum or the firm's E-mail system.

**4.08. Policy 3**

**Confirm the independence of another firm performing parts of an engagement, or when we act as principal auditor.**

**4.09. AnyCity CPAs implements this policy by-**

---

<sup>1</sup> AICPA'S *Professional Standards*, vol. 2, ET sec. 101.04, discusses circumstances when activities of a former practitioner could affect the firm's independence.

**10074 Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice**

- a. Using its purchased practice aids, which prescribe the form, content, and frequency of independence representations that are to be obtained.
- b. Requiring that such representations be documented.

**Personnel Management**

4.10. The objective of the *Personnel Management* element of a system of quality control is to provide the firm with reasonable assurance that all personnel have the proficiency to perform their assigned responsibilities. Attributes or qualities that enhance the proficiency of personnel who perform, supervise, or review work include integrity, objectivity, intelligence, judgment, competence, experience, and motivation.

4.11. AnyCity CPAs satisfies this objective by establishing and maintaining the following policies and procedures.

**4.12. Policy 1**

**Personnel who are hired will possess the appropriate characteristics to enable them to perform competently.**

4.13. AnyCity CPAs implements this policy by-

- a. Establishing a general understanding among the partners of the attributes, achievements, and experiences desired in entry-level and experienced personnel.
- b. Establishing criteria to evaluate personal characteristics such as integrity, competence, and motivation.
- c. Setting guidelines as to additional procedures that are necessary when hiring experienced personnel such as performing background checks and inquiring about any outstanding regulatory actions.
- d. Designating a qualified individual in the firm to be responsible for managing the human resource function.

**4.14. Policy 2**

**The firm will make personnel assignments based on the degree of technical training and proficiency required in the circumstances and the nature and extent of supervision to be provided.**

4.15. AnyCity CPAs implements this policy by conducting periodic partner and manager meetings to discuss the assignment of personnel to engagements. The factors to be considered in making such decisions include-

- Engagement size and complexity.
- Specialized experience and expertise required.

**Guide for Establishing and Maintaining a System of Quality 10075  
Control for a CPA Firm's Accounting and Auditing Practice**

- Personnel availability and involvement of supervisory personnel.
- Timing of the work to be performed.
- Continuity and rotation of personnel.
- Opportunities for on-the-job training.
- Situations where independence or objectivity concerns exist.

**4.16. Policy 3**

**Personnel will participate in general and industry-specific continuing professional education and professional development activities that enable them to satisfy responsibilities assigned and fulfill applicable continuing professional education requirements of the AICPA and regulatory agencies.**

4.17. AnyCity CPAs implements this policy by-

- a. Assigning responsibility to a partner to maintain an office professional development program that-
  - (1) Provides that personnel in the office participate in professional development programs in accordance with firm guidelines and in subjects that are relevant to their responsibilities.
  - (2) Considers requirements of the AICPA, state boards of accountancy, and regulatory agencies in establishing the firm's CPE requirements.
- b. Encouraging participation in other professional development activities for personnel at each level within the firm, such as participation in external professional development programs, including graduate-level and self-study courses, membership in professional organizations, serving on professional committees, and writing for professional publications.
- c. Communicating and distributing to personnel, when applicable, changes in accounting, auditing, and independence requirements and the firm's guidance with respect to them.

**4.18. Policy 4**

**Personnel selected for advancement will have the qualifications necessary to fulfill the responsibilities they will be called on to assume.**

4.19. AnyCity CPAs implements this policy by-

- a. Assigning responsibility to a partner for making advancement and termination decisions. Such responsibilities include-
  - Identifying responsibilities and requirements for evaluation at each level and indicating who will prepare evaluations and when they will be prepared.



**10076 Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice**

- Using forms for evaluating the performance of personnel.
  - Reviewing evaluations with the individual being evaluated on a timely basis.
- b. Counseling personnel regarding their progress and career opportunities by-
- (1) Annually summarizing and reviewing with personnel the evaluation of their performance, including an assessment of their progress with the firm. Considerations should include performance, future objectives of the firm and the individual, assignment preferences, and career opportunities.
  - (2) Periodically evaluating partners by means of counseling, peer evaluation, or self-appraisal, as appropriate.

**Acceptance and Continuance of Clients and Engagements**

4.20. The objective of the *Acceptance and Continuance of Clients and Engagements* element of a system of quality control is to establish criteria for deciding whether to accept or continue a client relationship and whether to perform a specific engagement for that client. Such policies and procedures should provide the firm with reasonable assurance that (a) the likelihood of association with a client whose management lacks integrity is minimized, (b) the firm undertakes only those engagements that can be completed with professional competence, (c) the risks associated with providing professional services in particular circumstances are appropriately considered, and (d) an understanding with the client regarding the services to be performed is reached.

4.21. AnyCity CPAs satisfies this objective, both with respect to the initial period for which the firm is performing its service and for subsequent periods, by establishing and maintaining the following policies and procedures.

**4.22. Policy 1**

**The firm will evaluate factors that have a bearing on managements integrity.**

- 4.23. AnyCity CPAs implements this policy by-
- a. Informing personnel of the firm's policies and procedures, including those outlined in the firm's purchased practice aids, for accepting and continuing clients.
  - b. Obtaining and evaluating available financial information regarding the client and its operations such as annual reports, interim financial statements, reports to regulatory agencies, income tax returns, and credit reports before accepting or continuing a client.

**Guide for Establishing and Maintaining a System of Quality 10077  
Control for a CPA Firm's Accounting and Auditing Practice**

- c. Making inquiries of the client management about the nature and purpose of services to be provided.
- d. Making inquiries of the client's bankers, factors, attorneys, credit services, and others having business relationships with the entity.
- e. Communicating with the predecessor accountant when required or suggested by professional standards.
- f. Evaluating the information obtained regarding management's integrity.

**4.24. Policy 2**

The firm will evaluate whether the engagement can be completed with professional competence and accordingly undertake only those engagements that can be completed with professional competence and appropriately consider the risk associated with providing professional services in particular circumstances.

**4.25. AnyCity CPAs implements this policy by-**

- a. Evaluating whether the firm has obtained or can reasonably expect to obtain the knowledge and expertise necessary to enable it to perform the engagement.
- b. Specifying conditions that require evaluation of a specific client or engagement, obtaining relevant information to determine whether the relationship should be continued, and establishing a time period for evaluations to be made (for example, continuance decisions should be made at least annually). Conditions include the following:
  - Significant changes in the client, for example, a major change in senior client personnel, ownership, advisors, the nature of its business, or the financial stability of the client.
  - Changes in the nature or scope of the engagement, including requests for additional services.
  - Changes in the composition of the firm, for example, the inability to replace the loss of key personnel who are particularly knowledgeable about a specialized industry, or the decision to discontinue services to clients in a particular industry.
  - The existence of conditions that would have caused the firm to reject the client or engagement had such conditions existed at the time of the initial acceptance.
  - Client delinquent in paying fees. (This may also affect the firm's independence.)
  - Engagements for entities operating in highly specialized or regulated industries, including financial institutions, governmental entities, and engagements for employee benefit plans.

**10078 Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice**

- Where there is a burdensome amount of hours required to complete the engagement.
  - Engagements for entities in the development stage.
- c. Evaluating the information obtained regarding acceptance or continuance of the client or engagement.
- (1) All information obtained about the client or the specific engagement is evaluated by the engagement partner, who makes a recommendation regarding whether the client or engagement is to be accepted or continued.
  - (2) The engagement partner completes a client acceptance form and submits it to the managing partner for approval.
  - (3) The engagement partner signs a step in the planning program noting client continuance, and a form documenting client continuance is completed if conditions identified above (paragraph 4.25b) exist.
  - (4) The managing partner is responsible for evaluating and approving the recommendation made by the engagement partner. If the managing partner recommends not accepting or discontinuing a client relationship, all partners in the firm will review all of the information and participate in the acceptance or continuance decision.

**4.26. Policy 3**

**The firm will obtain an understanding with the client regarding the services to be performed.**

4.27. AnyCity CPAs implements this policy by requiring that all understandings with the client be in writing by obtaining an engagement letter on all engagements, thus minimizing the risk of misunderstanding regarding the nature, scope, and limitations of the services to be performed.

**Engagement Performance**

4.28. The objective of the *Engagement Performance* element of a system of quality control is to provide the firm with reasonable assurance that the work performed by engagement personnel meets the applicable professional standards, regulatory requirements, and the firm's standards of quality. Policies and procedures for engagement performance encompass all phases of the design and execution of the engagement. To the extent appropriate and as required by applicable professional standards, these policies and procedures should cover planning, performing, supervising, reviewing, documenting, and communicating the results of each engagement. Policies and procedures should also provide that personnel refer to authoritative literature or other sources and consult, on a timely basis, with individuals within or outside the firm, when

**Guide for Establishing and Maintaining a System of Quality 10079  
Control for a CPA Firm's Accounting and Auditing Practice**

appropriate.

4.29. AnyCity CPAs satisfies this objective by establishing and maintaining the following policies and procedures.

**4.30. Policy 1**

**Planning for engagements will meet professional, regulatory, and the firm's requirements.**

4.31. AnyCity CPAs implements this policy by maintaining and providing personnel with the firm's purchased practice aids which prescribe the factors to be considered in the planning process by the engagement team and the extent of documentation of the considerations which may vary depending on the size and complexity of the engagement. Planning considerations include-

- Assigning responsibilities to appropriate personnel during the planning phase.
- Developing or updating background information.
- Developing a planning document that includes-
  - Proposed work programs, tailored to the specific engagement.
  - Staffing requirements and the need for specialized knowledge.
  - Considering the economic conditions affecting the client or its industry and their potential impacts on the conduct of the engagement.
  - Considering the risks and how they may affect the procedures to be performed.
  - Preparing a budget that allocates a sufficient amount of time so the engagement will be performed in accordance with professional standards and the firm's quality control policies and procedures.

**4.32. Policy 2**

**The engagement will be performed, supervised, reviewed, documented, and communicated in accordance with the requirements of professional standards, regulatory authorities, and the firm.**

4.33. AnyCity CPAs implements this policy by-

- a. Providing adequate supervision during the course of an engagement. This supervision is based on the training, ability, and experience of the personnel assigned.
- b. Adhering to the guidelines set forth by the firm and in its purchased practice aids for the form and content of working

**10080 Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice**

- papers.
- c. Utilizing appropriately tailored forms, checklists, and questionnaires to assist in the performance of the specific engagement.
  - d. Adhering to documentation guidelines set by the firm regarding the review of working papers, financial statements, and reports—
    - (1) All reviewers are to have appropriate experience, competence, and responsibility.
    - (2) All work performed and the reports and financial statements issued are to be complete and comply with professional standards and firm policy.
    - (3) All engagements require appropriate evidence of review of working papers, financial statements, and reports.
    - (4) All differences of professional judgment within an engagement team are to be resolved by the engagement and the managing partner. The resolution of the differences must be appropriately documented. If a member of the team continues to disagree with the resolution, he or she may disassociate himself or herself from the resolution of the matter and will be offered the opportunity to document that a disagreement still exists.

**4.34. Policy 3**

The firm will identify areas and specialized situations where consultation is required and will require personnel to refer to authoritative literature and practice aids and to consult, on a timely basis, with individuals within or outside the firm when appropriate (for example, when dealing with complex, unusual, or unfamiliar issues).

**4.35. AnyCity CPAs implements this policy by—**

- a. Informing personnel of the firm's consultation policies and procedures.
- b. Consulting with appropriate individuals within and outside the firm when issues arise in certain areas.
- c. Requiring consultation in specialized areas or specialized situations, which may include—
  - Application of newly issued technical pronouncements.
  - Industries with special accounting, auditing, or reporting requirements, including unusually complex employee benefit plans.
  - Emerging practice problems.
  - Choices among alternative generally accepted accounting principles upon initial adoption or when an accounting change is made.
  - Reissuance of a report, consideration of omitted

**Guide for Establishing and Maintaining a System of Quality 10081  
Control for a CPA Firm's Accounting and Auditing Practice**

procedures after a report has been issued or subsequent discovery of facts that existed at the time a report was issued.

- Filing requirements of regulatory agencies.
- d. Maintaining an adequate and up-to-date reference library that is accessible to all professional personnel and that includes materials related to clients served.
- e. Documenting all relevant facts, circumstances, professional literature used, and conclusions reached in the engagement working papers.
- f. Documenting the resolution of differences of opinion. If on some occasions there is an unresolved disagreement, an outside source may be consulted to assist in determining the appropriate application of accounting principles.

**Monitoring**

4.36. The objective of the *Monitoring* element of a system of quality control is to provide the firm with reasonable assurance that the policies and procedures relating to the other elements of quality control are suitably designed and being effectively applied. Monitoring is an ongoing consideration and evaluation process.

4.37. AnyCity CPAs satisfies this objective by establishing and maintaining the following policies and procedures.

**4.38. Policy 1**

**The firm will consider and evaluate, on an ongoing basis, the relevance and adequacy of its quality control policies and procedures.**

4.39. AnyCity CPAs implements this policy by designating a partner or a management-level individual with appropriate authority to be responsible for quality assurance, including-

- Assuring that the firm's quality control policies and procedures and its audit methodology remain relevant and adequate. Factors to be considered include-
  - Mergers and divestitures of portions of the practice.
  - Changes in professional standards or other regulatory requirements applicable to the firm's practice.
  - Results of annual inspections and peer reviews.
  - Review of litigation and regulatory enforcement actions against the firm and others.
  - Impact that changes in technology may have on clients' methods of doing business.
  - Changes in clients' industries that impact their

**10082 Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice**

operations.

- Changes in applicable AICPA membership requirements.
- Determining whether personnel have been appropriately informed of their responsibilities for maintaining the firm's standards of quality in performing their duties.
- Identifying the need to-
  - a. Revise policies and procedures related to the other elements of quality control because they are ineffective or inappropriately designed.
  - b. Improve compliance with firm policies and procedures that are related to the other elements of quality control.

**4.40. Policy 2**

**The firm will consider and evaluate, on an ongoing basis, the appropriateness of its guidance materials and any practice aids.**

4.41. AnyCity CPAs implements this policy by-

- a. Reviewing and evaluating firm practice aids, such as audit programs, forms, and checklists, based on the issuance of new professional pronouncements.
- b. Providing guidance during staff meetings regarding new professional standards, regulatory requirements, and related changes to firm practice aids.

**4.42. Policy 3**

**The firm will consider and evaluate, on an ongoing basis, the effectiveness of professional development programs.**

4.43. AnyCity CPAs implements this policy by-

- a. Designating a management-level individual with the responsibility for reviewing the professional development policies and procedures to determine whether they are appropriate, effective, and meeting the needs of the firm.
- b. Designating a management-level individual to review summaries of CPE records for the firm's personnel to determine that the office has established a means of tracking each individual's compliance with the requirements of the AICPA and other regulatory bodies.
- c. Soliciting information from the firm's personnel during staff meetings regarding the effectiveness of training programs.

**4.44. Policy 4**

**The firm will consider and evaluate, on an ongoing basis, compliance with its policies and procedures.**

**Guide for Establishing and Maintaining a System of Quality 10083  
Control for a CPA Firm's Accounting and Auditing Practice**

4.45. For purposes of illustration, two scenarios are described. Scenario I illustrates how AnyCity CPAs satisfies the objective of Policy 4 without performing an inspection of individual engagements. Scenario II illustrates how AnyCity CPAs implements Policy 4 through the use of engagement inspection.

4.46. In determining which scenario is appropriate, consideration should be given to SQCS No. 3, *Monitoring a CPA Firm's Accounting and Auditing Practice*, paragraphs 3-7, which sets forth guidance that should be consulted in determining the extent of inspection procedures to be performed, including those related to individual engagements. Also, consideration should be given to time pressures such as report due dates and time budgets when considering whether a firm can effectively monitor its compliance with its policies and procedures through preissuance or postissuance engagement reviews.

**Scenario I**

4.47. AnyCity CPAs implements Policy 4 by-

- a. Designating a partner or management-level individual not previously associated with the engagement to perform a preissuance review of the engagement or a postissuance review of the engagement shortly after the release of the report. Deficiencies identified as a result of this process will be continuously summarized and evaluated to determine whether --
  - (1) Additional emphasis should be placed on the specific areas or industries in future engagements.
  - (2) Existing policies and procedures should be modified so any deficiencies noted do not recur.
- b. Reviewing correspondence regarding consultation on independence, integrity, and objectivity matters, and acceptance and continuance decisions.
- c. Reviewing the resolution of matters reported by professional personnel on independence circularization forms to determine that matters have been appropriately considered and resolved.
- d. Summarizing the deficiencies noted resulting from the preissuance and postissuance reviews.
- e. Preparing a summary of the deficiencies noted for the partner or management group in order to set forth any recommended changes to the firm's policies and procedures.
- f. Communicating the deficiencies noted and the agreed-upon quality control changes to all professional personnel.

**Scenario II**

4.48. AnyCity CPAs implements Policy 4 by-

- a. Designating a partner to be responsible for performing an annual inspection using guidance prepared by the AICPA for



**10084 Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice**

performing inspection procedures. These procedures include reviewing a cross-section of engagements using the following criteria:

- (1) Significant specialized industries with emphasis given to high-risk engagements
  - (2) Engagements for employee benefits
  - (3) First-year engagements
  - (4) Level of service performed (that is, audit, review, compilation, and attest)
  - (5) All partners and other management level personnel having accounting and auditing responsibilities
- b. Reviewing correspondence regarding consultation on independence, integrity, and objectivity matters, and acceptance and continuance decisions.
  - c. Reviewing the resolution of matters reported by professional personnel on independence circularization forms to determine that matters have been appropriately considered and resolved.
  - d. Summarizing findings resulting from the inspection procedures.
  - e. Preparing a summary inspection report for the partner or management group that evaluates the overall results of the inspection and that sets forth any recommended changes to the firm's policies and procedures.
  - f. Communicating inspection findings and agreed-upon quality control changes to all professional personnel.

**Guide for Establishing and Maintaining a System of Quality 10085  
Control for a CPA Firm's Accounting and Auditing Practice**

**Chapter 5**

**Jane Brown, CPA's System of Quality Control for Her Accounting Practice**

5.01. This chapter describes how Jane Brown, CPA implements each element of quality control for her accounting practice. Jane Brown, CPA is a hypothetical firm that is presumed to be a sole owner without any professional staff who occasionally hires per diem professionals. Her accounting practice consists only of engagements subject to the Statements on Standards for Accounting and Review Services. She uses purchased practice aids that have been subjected to peer review in accordance with standards established by the AICPA. Jane Brown, CPA recognizes that her policies and procedures will have to be changed if she hires full-time or part-time professional staff.

**Independence, Integrity, and Objectivity**

5.02. The objective of the *Independence, Integrity, and Objectivity* element of a system of quality control is to provide the firm with reasonable assurance that personnel maintain independence (in fact and in appearance), in all required circumstances, perform all professional responsibilities with integrity, and maintain objectivity in discharging professional responsibilities.

5.03. Jane Brown, CPA satisfies this objective by establishing and maintaining the following policy and procedures.

**5.04. Policy 1**

**I will adhere to applicable independence, integrity, and objectivity requirements. These requirements include regulations, interpretations, and rulings of the AICPA, state CPA societies, state boards of accountancy, state statutes, and other regulatory agencies where applicable.**

5.05. Jane Brown, CPA implements this policy by-

- a. Purchasing AICPA Professional Standards annually.
- b. Reviewing unpaid fees from clients to ascertain whether any outstanding amounts impair the firm's independence.
- c. Reviewing relevant pronouncements relating to independence, integrity, and objectivity in the Journal of Accountancy and retaining copies of them.
- d. Signing a step on each engagement program attesting to her independence and requiring per diem personnel to do the same.
- e. Complying with Statements on Standards for Accounting and Review Services with respect to disclosing instances where the

**10086 Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice**

firm is not independent in the accountant's compilation report.

**Personnel Management**

5.06. The objective of the *Personnel Management* element of a system of quality control is to provide the firm with reasonable assurance that all personnel have the proficiency to perform their assigned responsibilities. Attributes or qualities that enhance the proficiency of personnel who perform, supervise, or review work include integrity, objectivity, intelligence, judgment, competence, experience, and motivation.

5.07. Jane Brown, CPA satisfies this objective by establishing and maintaining the following policies and procedures.

**5.08. Policy 1**

**I will maintain the degree of technical training and proficiency required in the circumstances.**

5.09. Jane Brown, CPA implements this policy by-

- a. Evaluating the knowledge and expertise required to perform the engagement prior to accepting the client or engagement.
- b. Accepting only those engagements that can be performed with professional competence.

**5.10. Policy 2**

**I will participate in general and industry-specific continuing professional education and professional development activities that enable me to satisfy my responsibilities and fulfill applicable continuing professional education requirements of the AICPA and regulatory agencies.**

5.11. Jane Brown, CPA implements this policy by-

- a. Developing a professional development program and considering the requirements of the AICPA and state boards of accountancy.
- b. Participating in external professional development programs, including graduate-level and self-study courses.
- c. Joining and becoming an active member of professional organizations.
- d. Serving on professional committees, writing for professional publications, when appropriate, and participating in other professional activities.
- e. Considering changes in the applicable professional standards when determining her professional development program.

**Acceptance and Continuance of Clients and Engagements**

5.12. The objective of the *Acceptance and Continuance of Clients and Engagements* element of a system of quality control is to establish criteria for deciding whether to accept or continue a client relationship and whether to perform a specific engagement for that client. Such policies and procedures should provide the firm with reasonable assurance that (a) the likelihood of association with a client whose management lacks integrity is minimized, (b) the firm undertakes only those engagements that can be completed with professional competence, (c) the risks associated with providing professional services in particular circumstances are appropriately considered, and (d) an understanding with the client regarding the services to be performed is reached.

5.13. Jane Brown, CPA satisfies this objective, both with respect to the initial period for which the firm is performing its service and for subsequent periods, by establishing and maintaining the following policies and procedures.

**5.14. Policy 1**

**I will evaluate factors that have a bearing on management's integrity.**

5.15. Jane Brown, CPA implements this policy by-

- a. Obtaining information such as the following before accepting or continuing a client:
  - Available information regarding the client and its operations from sources such as prior-year reports, internally generated financial statements (if applicable), income tax returns, and credit reports.
  - The nature and purpose of the services to be provided.
- b. Inquiring of third parties such as bankers, factors, legal counsel.
- c. Communicating with the predecessor accountant when required or suggested by professional standards.
- d. Evaluating the information obtained regarding management's integrity.

**5.16. Policy 2**

**I will evaluate whether the engagement can be completed with professional competence and accordingly undertake only those engagements that can be completed with professional competence and appropriately consider the risk associated with providing professional services in particular circumstances.**

**10088 Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice**

5.17. Jane Brown, CPA implements this policy by-

- a. Considering conditions that require evaluation of a client or specific engagement and obtaining the relevant information to determine whether the relationship should be continued. Conditions include-
  - Establishing a time period for evaluations to be made (before the current-year engagement work begins).
  - Significant changes in the client, for example, a major change in ownership, senior client personnel, directors, advisors, the nature of the business, or the financial stability of the client.
  - Changes in the nature or scope of the engagement, including requests for additional services.
  - The existence of conditions that would have caused the firm to reject the client or engagement had such conditions existed at the time of the initial acceptance.
  - Client delinquent in paying fees. (This may also affect the firm's independence.)
- b. Determining if the knowledge and expertise necessary to perform the engagement exists or can reasonably be obtained.
- c. Evaluating the information obtained regarding the engagement and making the acceptance decision and documenting her evaluation or conclusion in a memorandum.
- d. Evaluating the information obtained regarding the engagement and making the continuance decision.

**5.18. Policy 3**

**I will obtain an understanding with the client regarding services to be performed.**

5.19. Jane Brown, CPA implements this policy by-

- a. Adhering to all requirements set forth in professional standards regarding obtaining an understanding with the client.
- b. Requiring that the understanding with the client be documented either through an engagement letter or in a memorandum.

**Engagement Performance**

5.20. The objective of the *Engagement Performance* element of a system of quality control is to provide the firm with reasonable assurance that the work performed by engagement personnel meets the applicable professional standards, regulatory requirements, and the firm's standards of quality. Policies and procedures for engagement performance encompass all phases of the design and execution of the engagement. To the extent appropriate and as required by applicable

**Guide for Establishing and Maintaining a System of Quality 10089  
Control for a CPA Firm's Accounting and Auditing Practice**

professional standards, these policies and procedures should cover planning, performing, supervising, reviewing, documenting, and communicating the results of each engagement. Policies and procedures should also provide that personnel refer to authoritative literature or other sources and consult, on a timely basis, with individuals within or outside the firm, when appropriate (for example, when dealing with complex, unusual, or unfamiliar issues).

5.21. Jane Brown, CPA satisfies this objective by establishing and maintaining the following policies and procedures.

**5.22. Policy 1**

**I will plan engagements to meet professional and the firm's requirements.**

5.23. Jane Brown, CPA implements this policy by adhering to professional standards regarding the planning process and the extent of documentation, if applicable. Engagement planning considerations may include, when applicable-

- Developing or updating background information.
- Obtaining an engagement letter.
- Reviewing prior financial statements and accountant's report.
- Using work programs.

**5.24. Policy 2**

**I will perform, supervise, review, document, and communicate in accordance with the requirements of professional standards and the firm.**

5.25. Jane Brown, CPA implements this policy by requiring the use of purchased practice aids on all appropriate engagements including-

- Maintaining availability of purchased practice aids and AICPA professional standards.
- Preparing all working papers and checklists in accordance with firm policy in order to document work performed in accordance with professional standards.
- Reviewing and initialing all engagement working papers in situations where per diem staff are utilized.

**5.26. Policy 3**

**I will identify areas and specialized situations where consultation is required and I will require personnel to refer to authoritative literature and practice aids and will consult, on a timely basis,**

**10090 Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice**

**with individuals outside the firm when appropriate (for example, when dealing with complex, unusual, or unfamiliar issues).**

5.27. Jane Brown, CPA implements this policy by-

- a. Maintaining a technical reference library to assist in resolving practice problems. The library is updated as needed.
- b. Referring to the AICPA's Technical Hotline when a practice problem arises for which the firm needs additional expertise.
- c. Requiring that documentation of consultation include all relevant facts and circumstances and references to professional literature used in the determination and conclusion reached. This documentation is to be retained in the engagement working papers.

**Monitoring**

5.28. The objective of the *Monitoring* element of a system of quality control is to provide the firm with reasonable assurance that the procedures relating to the other elements of quality control are suitably designed and being effectively applied. Monitoring is an ongoing consideration and evaluation process.

5.29. Jane Brown, CPA satisfies this objective by establishing and maintaining the following policies and procedures.

5.30. **Policy 1**

**I will consider and evaluate, on an ongoing basis, the relevance and adequacy of my quality control policies and procedures.**

5.31. Jane Brown, CPA implements this policy by reviewing procedures that identify the need to-

- a. Revise policies and procedures that are ineffective due to changes in professional standards or the nature of the practice.
- b. Improve compliance with firm policies and procedures that are related to the other elements of quality control.

5.32. **Policy 2**

**I will consider and evaluate, on an ongoing basis, the appropriateness of my guidance materials and any practice aids.**

5.33. Jane Brown, CPA implements this policy by reviewing and determining that the firm's purchased practice aids are up-to-date based on the issuance of new professional pronouncements.

**Guide for Establishing and Maintaining a System of Quality 10091  
Control for a CPA Firm's Accounting and Auditing Practice**

**5.34. Policy 3**

**I will consider and evaluate, on an ongoing basis, the effectiveness of professional development activities.**

**5.35. Jane Brown, CPA implements this policy by-**

- a. Reviewing CPE records to determine whether the programs (AICPA or state society classroom training and self-study programs) are appropriate for the firm's practice.**
- b. Reviewing CPE records to determine compliance with the requirements of the AICPA and other regulatory bodies.**

**5.36. Policy 4**

**I will consider and evaluate, on an ongoing basis, compliance with my policies and procedures.**

**5.37. Jane Brown, CPA implements this policy by performing a postissuance review of selected engagements, in order to-**

- a. Summarize findings resulting from such reviews.**
- b. Place additional emphasis on certain deficient areas in future engagements.**
- c. Determine if existing policies and procedures should be modified so any deficiencies noted do not recur.**



10092 Guide for Establishing and Maintaining a System of Quality  
Control for a CPA Firm's Accounting and Auditing Practice

**Glossary of Selected Terms**

**Accounting and auditing practice.** All audit, attest, accounting and review, and other services for which standards have been established by the AICPA Auditing Standards Board or the AICPA Accounting and Review Services Committee under rules 201 or 202 of the AICPA Code of Professional Conduct (AICPA, *Professional Standards*, vol. 2, ET secs. 201 and 202). Standards may be also established by other AICPA technical committees; engagements that are performed in accordance with those standards are not encompassed in the definition of an accounting and auditing practice.

**Firm.** Defined in the AICPA Code of Professional Conduct as "a form of organization permitted by state law or regulation whose characteristics conform to resolutions of Council that is engaged in the practice of public accounting, including the individual owners thereof" (AICPA, *Professional Standards*, vol. 2, ET sec. 92.05).

**Personnel.** All individuals who perform professional services for which the firm is responsible, whether or not they are CPAs.

**Policy.** A definite course or method of action to guide and determine present and future decisions. It is a guide to decision making under a given set of circumstances within the framework of a firm's objectives, goals, and management philosophies.

**Procedure.** A particular way of accomplishing something, an established way of doing things, a series of steps followed in a definite regular order. It provides for the consistent and repetitive approach to actions.



July 2000

To the SEC Practice Section Member Firms

**Update Number 12 to the SEC Practice Section Reference Manual**

Enclosed is Update Number 12 to the *SEC Practice Section Reference Manual*. Separate filing instructions for this update are included.

This update contains certain revisions to the *Organizational Structure and Functions of the SEC Practice Section of the AICPA Division for CPA Firms* (Section 1000) that reflect the following:

- The issuance of a new membership requirement for Independence and Quality Control that now requires member firms to address certain quality control aspects of independence including continuing professional education in independence matters.
- The issuance of a new membership requirement containing certain quality control aspects for member firms with international affiliates or correspondents that audit foreign registrants who file reports with the Securities and Exchange Commission.
- Revisions and enhancements to the existing membership requirement and the related appendix for concurring partner review on audits of SEC clients.

Also included in this update are revisions to Section II, SECPS Peer Review Program Standards that incorporate recent revisions adopted by the SEC Practice Section Peer Review Committee.

If you have any questions concerning this update, please contact the SEC Practice Section staff at 201-938-3030 or by e-mail at [secps@aicpa.org](mailto:secps@aicpa.org). As always, we appreciate your support of the Section and its activities.

018040

**Instructions for Filing Update No. 12 to the  
SECPS Practice Section Reference Manual**

The following materials in the loose-leaf manual should be removed and replaced in accordance with the filing instructions below.

	<u>Pages to Remove</u>	<u>Pages to Insert</u>
<b>SEC Practice Section Reference Manual</b>	Title page/copyright page	Title page/copyright page
	Table of Contents	Table of Contents
<b>Section I - SEC Practice Section (SECPS)</b>		
<b>Section 1000 – Organizational Structure and Functions</b>	1001 - 1038	1001 - 1051
<b>Section II - SECPS Peer Review Program Standards</b>		
<b>Section 2000 – Standards for Performing and Reporting on Peer Reviews</b>	Title Page/ Notice to Readers  2001 - 2076	Title Page/ Notice to Readers  2001 - 2076
<b>Section 2200 - Writing Letters of Comments</b>	2239 - 2240	2239 - 2240
<b>Section 2300 – Writing Letters of Response</b>	2303 - 2306	2303 - 2306
<b>Section 2400 – Reviews of Quality Control Materials</b>	2403 - 2404	2403 - 2404
<b>Section 2600 – Writing Letters on Monitoring Actions by Outside Parties</b>	2605 - 2606 2611 - 2612	2605 - 2606 2611 - 2612
<b>Section III – Associations</b>		
<b>Section 3000 – Guidelines for Association Involvement</b>	3001 - 3007	3001 - 3007

<b>Section V – Administration</b>	<b>Table of Contents</b>	<b>Table of Contents</b>
<b>Section 5000 – Administrative Procedures</b>	5001 - 5022	5001 - 5023
<b>Appendixes</b>	10,001 - 10,081	10,001 - 10,092
<b>Last Update Letter</b>	—	<b>Update Letter No. 12</b>



Division for CPA Firms

July 1998

To Member Firms of the  
SEC Practice Section

**Update No. 11 to the SEC Practice Section Peer Review Reference Manual**

Enclosed is Update No. 11 to the *SEC Practice Section Peer Review Reference Manual*. Separate filing instructions for this update are enclosed.

This update contains revisions to *Organizational Structure and Functions of the SEC Practice Section of the AICPA Division for CPA Firms* (Section 1000), which reflect the following:

- A clarification of the requirement that a partner be in charge of each SEC engagement. Also, a definition of a partner as an individual who is legally a partner, owner or shareholder in a CPA firm or a sole practitioner, and who should be a party to any partnership, ownership or shareholder agreement of a CPA firm.
- A clarification of the criteria for an exception to the partner rotation requirement on an SEC engagement to indicate that the requirement does not apply to member firms that meet both of the following criteria: (a) less than five SEC clients, and (b) less than ten partners.
- An expansion of the definition of an SEC engagement to include an employee stock purchase or similar plan that files a Form 11-K with the SEC.
- Changes to the SEC Practice Section dues.

Revisions to *Guidelines for and Illustrations of Peer Review Reports* (Section 2100) and *Guidelines for and Illustrations of the Letter of Comments* (Section 2200) were made to reflect a change in the use of the word “unqualified” to the word “unmodified” as it relates to peer review reporting. Other changes were made to the illustrative peer review reports and the letter of comments in an effort to make such reports more “user friendly” in practice. Conforming changes were also made to sections 1000, 2000, 2300, 2400, 3000 and 5000 to consistently reflect these changes throughout the SECPS Reference Manual. (The new formats for reports and letters of comments illustrated in Sections 2100 and 2200 should be used for SECPS peer reviews **commencing on or after September 1, 1998**. However, earlier implementation of the new formats is encouraged.)

*Guidelines for Involvement by State CPA Societies* (Section 4000) was deleted from the SECPS Reference Manual due to its lack of applicability.

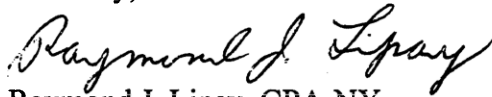
018032

SECPS Member Firms  
July 1998  
Page Two

Revisions to *Objectives, Organization and Operations of the Quality Control Inquiry Committee* (Section 7000) reflect changes to the structure of the Quality Control Inquiry Committee to indicate that each Committee member shall be appointed for a one-year term, and will be eligible for reappointment for additional one year terms. Also, the revision clarifies the procedure relating to potential conflicts of interest among Committee members.

If you have any questions about this update, you may contact us by mail or by calling (201) 938-3030.

Sincerely,

A handwritten signature in cursive script that reads "Raymond J. Lipay".

Raymond J. Lipay, CPA-NY  
Senior Technical Manager  
SECPS Peer Review Program

Enclosures

**Instructions for Filing Update No. 11 to the  
SEC Practice Section Reference Manual**

The following materials in the loose-leaf manual should be removed and replaced in accordance with the filing instructions below.

<b>SEC Practice Section Reference Manual</b>	<b><u>Pages to Remove</u></b>	<b><u>Pages to Insert</u></b>
	Title page/ copyright page Table of Contents	Title page/ copyright page Table of Contents
<hr/>		
<b>Section I—SEC Practice Section of the AICPA Division for CPA Firms</b>		
<i>Section 1000—Organizational Structure and Functions of the SEC Practice Section of the AICPA Division for CPA Firms</i>	1005 - 1016 1023 - 1026 1037 - 1038	1005 - 1016 1023 - 1026 1037 - 1038
<hr/>		
<b>Section II—SEC Practice Section Peer Review Program Standards</b>		
<i>Section 2000—Standards for Performing and Reporting on Peer Reviews</i>	Title page/ Notice to Readers Page 2001 - 2049 2061 - 2073	Title page/ Notice to Readers Page 2001 - 2049 2061 - 2076
<i>Section 2100—Guidelines for and Illustrations of Peer Review Reports</i>	2101 - 2122	2101 - 2121
<i>Section 2200—Guidelines for and Illustrations of the Letter of Comments</i>	2201 - 2267	2201 - 2270
<i>Section 2300—Suggestions for Writing a Response to a Letter of Comments</i>	2303 - 2306	2303 - 2306
<i>Section 2400—Standards for Performing and Reporting On Reviews of Quality Control Materials</i>	2401 - 2418	2401 - 2416
<hr/>		
<b>Section III—Associations</b>		
<i>Section 3000—Guidelines for Involvement by Associations of CPA Firms</i>	3001 - 3006	3001 - 3007
<hr/>		
<b>Section IV—State CPA Societies</b>		
<i>Section 4000—Guidelines for Involvement by State CPA Societies</i>	Table of Contents 4001- 4006	-
<i>(Remove the following Guide Cards: IV - State CPA Societies, and SECPS 4000 - Guidelines for State CPA Society Involvement)</i>		
<hr/>		
<b>Section V—Administration</b>		
<i>Section 5000—Administrative Procedures of the SECPS Peer Review Committee</i>	5001 - 5022	5001 - 5022
<hr/>		

---

**Section VII—Quality Control Inquiry Committee**

*Section 7000—Objectives, Organization, and Operations  
of the Quality Control Inquiry Committee*

7005 - 7006

7005 - 7006

---

**Section IX—Professional Issues Task Force**

*Section 9000—Objectives, Organization, and Operations of  
the Professional Issues Task Force*

9003 - 9004

9003 - 9004

---

**Last Update Letter**

---

**Update Letter No. 11**

---





Division for CPA Firms

July 1997

To Member Firms of the  
SEC Practice Section

**Update No. 10 to the SEC Practice Section Peer Review Reference Manual**

Enclosed is Update No. 10 to the *SEC Practice Section Peer Review Reference Manual*. Separate filing instructions for this update are enclosed.

This update contains the revisions to the *Objectives, Organization, and Operations of the Quality Control Inquiry Committee* (Section 7000) and to the Appendixes (Section 10000). The revisions to Section 7000 reflect formatting changes while Section 10000 now includes Statements on Quality Control Standards Numbers 2 and 3 and the *Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice*.

If you have any questions about this update, you may contact us by mail or by calling (201) 938-3030.

Sincerely,

David Brumeloe, CPA-Georgia  
Senior Technical Manager  
SECPS Peer Review Program

Enclosures

018031

**Instructions for Filing Update No. 10 to the  
SEC Practice Section Reference Manual**

The following materials in the loose-leaf manual should be removed and replaced in accordance with the filing instructions below.

<b>SEC Practice Section Reference Manual</b>	<b>Pages to Remove</b>	<b>Pages to Insert</b>
	Title page/ copyright page	Title page/ copyright page
<hr/>		
<b>Section VII—Quality Control Inquiry Committee</b>		
<i>Section 7000—Objectives, Organization, and Operations of the Quality Control Inquiry Committee</i>	7001 - 7015	7001 - 7018
<hr/>		
<b>Section X—Appendixes</b>		
<i>Section 10000—Appendixes</i>	10001 - 10042	10001 - 10081
<hr/>		
<b>Last Update Letter</b>	---	<b>Update Letter No. 10</b>
<hr/>		



Division for CPA Firms

June 1997

To Member Firms of the  
SEC Practice Section

**Update No. 9 to the SEC Practice Section Peer Review Reference Manual**

Enclosed is Update No.9 to the *SEC Practice Section Peer Review Reference Manual*. Separate filing instructions for this update are enclosed.

This update contains the revisions to the SECPS Peer Review Program Standards. The revisions reflect changes to the Standards for Performing and Reporting on Peer Reviews and also to conform to the requirements of Statements on Quality Control Standards Nos. 2 and 3, effective January 1, 1997.

If you have any questions about this update, you can contact us via mail or by calling (201) 938-3030.

Sincerely,

David Brumbeloe, CPA-GA  
Senior Technical Manager  
SECPS Peer Review Program

Enclosures

018030

## Instructions for Filing Update No. 9 to the SEC Practice Section Reference Manual

The following materials in the loose-leaf manual should be removed and replaced in accordance with the filing instructions below.

<b>SEC Practice Section Reference Manual</b>	<b>Pages to Remove</b>	<b>Pages to Insert</b>
	Title page/ copyright page Table of Contents	Title page/ copyright page Table of Contents
<b>Section I—SEC Practice Section (SECPS)</b>		
<i>Section 1000—Organizational Structure and Functions</i>	1001-1037	1001-1038
<b>Section II—Peer Review Program Standards</b>		
<i>Section 2000—Standards for Performing and Reporting on Peer Reviews</i>	Cover page/ Notice to Readers 2001 - 2064	Cover page/ Notice to Readers 2001 - 2073
<i>Section 2100—Guidelines for and Illustrations of Peer Review Reports</i>	2101 - 2129	2101 - 2122
<i>Section 2200—Guidelines for and Illustrations of the Letter of Comments</i>	2201 - 2274	2201 - 2267
<i>Section 2300—Suggestions for Writing a Response to a Letter of Comments</i>	2301 - 2308	2301 - 2308
<i>Section 2400—Standards for Performing and Reporting On Reviews of Quality Control Materials</i>	2401 - 2417	2401 - 2418
<i>Section 2500—Guidelines for Review of Continuing Professional Education Programs</i>	2501 - 2504	2501 - 2504
<i>Section 2600—Guidelines for Writing Letters on Monitoring Actions by Outside Parties</i>	2601 - 2612	2601 - 2612
<b>Section III—Associations</b>		
<i>Section 3000—Guidelines for Involvement by Associations of CPA Firms</i>	3001 - 3008	3001 - 3006
<b>Section IV—State CPA Societies</b>		
<i>Section 4000—Guidelines for Involvement by State CPA Societies</i>	4001- 4006	4001 - 4006
<b>Section V—Administration</b>		
<i>Section 5000—Administrative Procedures of the SECPS Peer Review Committee</i>	Table of Contents 5001 - 5022	Table of Contents 5001 - 5022
<b>Section VI—SECPS Peer Review Committee</b>		
<i>Section 6000—SECPS Peer Review Committee Meeting and Voting Procedures</i>	Table of Contents 6001 - 6008	Table of Contents 6001 - 6008

---

**Section VIII—Continuing Professional Education**

*Section 8000—Continuing Professional Education Requirements*

8001 - 8014

8001 - 8014

---

**Section IX—Professional Issues Task Force**

*Section 9000—Objectives, Organization, and Operations of  
the Professional Issues Task Force*

Table of Contents  
9001 - 9004

Table of Contents  
9001 - 9004

---

**Last Update Letter**

---

**Update Letter No. 9**

---



Division for Firms

April 1996

To the Managing Partners of SEC  
Practice Section Member Firms

***Update No. 8 to the SEC Practice Section Reference Manual***

Enclosed is the update to the *SEC Practice Section Reference Manual*. Separate filing instructions are also enclosed.

This update includes a revision to the peer review standards to describe the circumstances under which disagreements in the application of professional standards will be considered by an arbitration panel appointed by the chair of the AICPA Professional Ethics Executive Committee. In addition, "Appendix J - SEC Practice Section Dues" of the organizational structure and functions of the SEC Practice Section, was revised to describe the 1996 dues structure.

Please write to us if you have any questions about this update.

Sincerely,

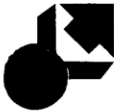
Karen H. Jones, CPA  
Senior Technical Manager  
SECPS Peer Review Program

Enclosures

**Instructions for Filing Update No. 8 to the  
SEC Practice Section Reference Manual**

The following materials in the loose-leaf manual should be removed and replaced in accordance with the filing instructions below.

<b>SEC Practice Section Reference Manual</b>	<b><u>Pages to Remove</u></b>	<b><u>Pages to Insert</u></b>
	Title page/ copyright page	Title page/ copyright page
<hr/>		
<b><i>Section I – SEC Practice Section (SECPS)</i></b>		
<i>Section 1000 – Organizational Structure and Functions</i>	1037	1037
<hr/>		
<b><i>Section II – Peer Review Program Standards</i></b>		
<i>Section 2000 – Standards for Performing and Reporting on Peer Reviews</i>	Cover page/ Notice to Readers 2029 – 2030	Cover page/ Notice to Readers 2029 – 2030
<i>Section 2300 – Writing Letters of Response</i>	2303 – 2304	2303 – 2304
<hr/>		
<b><i>Section V – Administration</i></b>		
<i>Section 5000 – Administrative Procedures</i>	5011 – 5012 5021 – 5022	5011 – 5012 5021 – 5022
<hr/>		
<b><i>Section VI – Peer Review Committee</i></b>		
<i>Section 6000 – Meeting and Voting Procedures</i>	6005 – 6006	6005 – 6006
<hr/>		
<b><i>Last Update Letter</i></b>	---	<b><i>Update Letter No. 8</i></b>
<hr/>		



Division for Firms

November 1995

To the Managing Partners of SEC  
Practice Section Member Firms

**Update No. 7 to the SEC Practice Section Reference Manual**

Enclosed is the update to the SEC Practice Section Reference Manual. Separate filing instructions are enclosed.

This update includes a revision to "Appendix E - Scope of the Concurring Review Requirement" of the organizational structure and functions of the SEC Practice Section. This was revised to clarify the nature and extent of the concurring reviewer's responsibilities on SEC engagements.

Please write to us if you have any questions about this update.

Sincerely,

Karen H. Jones, CPA  
Senior Technical Manager  
Peer Review Division

Enclosures

018028

American Institute of Certified Public Accountants  
Harborside Financial Center, 201 Plaza Three, Jersey City, NJ 07311-3881 (201) 938-3005 • (212) 318-0500 • fax (201) 938-3404



**Instructions for Filing Update No. 7 to the  
SEC Practice Section Reference Manual**

The following materials in the loose-leaf manual should be removed and replaced in accordance with the filing instructions below.

	<u>Pages to Remove</u>	<u>Pages to Insert</u>
<b>SEC Practice Section Reference Manual</b>	Title page/ copyright page	Title page/ copyright page
<hr/>		
<b>Section I – SEC Practice Section (SECPS)</b>		
<i>Section 1000 – Organizational Structure and Functions</i>	1025 – 1036	1025 – 1037
<hr/>		
<b>Last Update Letter</b>	---	<b>Update Letter No. 7</b>
<hr/>		

**Instructions for Filing Update No. 6 to the  
SEC Practice Section Reference Manual**

The following materials in the loose-leaf manual should be removed and replaced in accordance with the filing instructions below.

<b>SEC Practice Section Reference Manual</b>	<b><u>Pages to Remove</u></b>	<b><u>Pages to Insert</u></b>
	Title page/ copyright page Table of Contents	Title page/ copyright page Table of Contents
<b>Section I – SEC Practice Section (SECPS)</b>		
<i>Section 1000 – Organizational Structure and Functions</i>	1003 – 1006 1021 – 1022 1035 – 1036	1003 – 1006 1021 – 1022 1035 – 1036
<b>Section II – Peer Review Program Standards</b>		
<i>Section 2000 – Standards for Performing and Reporting on Peer Reviews</i>	Table of Contents  Cover page/ Notice to Readers 2005 – 2008 2031 – 2032	Table of Contents  Cover page/ Notice to Readers 2005 – 2008 2031 – 2032
<i>Section 2100 – Peer Review Reports</i>	2123 – 2126 2129	2123 – 2126 2129
<i>Section 2200 – Writing Letters of Comments</i>	2201 – 2256	2201 – 2274
<i>Section 2300 – Writing Letters of Response</i>	2303 – 2306	2303 – 2306
<i>Section 2400 – Reviews on Quality Control Materials</i>	2413 – 2414	2413 – 2414
<i>Section 2600 – Writing Letters on Monitoring Actions by Outside Parties</i>	---	Insert tab marked "SECPS 2600 Writing Letters on Monitoring Actions by Outside Parties" following page 2504  ---
		2601 – 2612
<b>Section V – Administration</b>		
<i>Section 5000 – Administrative Procedures</i>	5003 – 5004 5007 – 5008 5019 – 5022	5003 – 5004 5007 – 5008 5019 – 5022
<b>Section VI – Peer Review Committee</b>		
<i>Section 6000 – Meeting and Voting Procedures</i>	6001 – 6008	6001 – 6008
<b>Section VIII – Continuing Professional Education</b>		
<i>Section 8000 – Membership Requirements</i>	8003 – 8006	8003 – 8006
<b>Last Update Letter</b>	---	<b>Update Letter No. 6</b>

**Instructions for Filing Update No. 5 to the  
SEC Practice Section Reference Manual**

The following materials in the loose-leaf manual should be removed and replaced in accordance with the filing instructions below.

	<u>Pages to Remove</u>	<u>Pages to Insert</u>
<b>SEC Practice Section Reference Manual</b>	Title page/ copyright page Table of Contents	Title page/ copyright page Table of Contents
<hr/>		
<b>Section I – SEC Practice Section (SECPS)</b>		
<i>Section 1000 – Organizational Structure and Functions</i>	1011 – 1012 1025 – 1026 1029 – 1030	1011 – 1012 1025 – 1026 1029 – 1030
<hr/>		
<b>Section II – Peer Review Program Standards</b>	Table of Contents	Table of Contents
<i>Section 2000 – Standards for Performing and Reporting         on Peer Reviews</i>	Cover page/ Notice to Readers 2003 2033 – 2034 2041 – 2042 ---	Cover page/ Notice to Readers 2003 2033 – 2034 2041 – 2042 2063 – 2064
<i>Section 2300 – Writing Letters of Response</i>	2301 – 2308	2301 – 2308
<hr/>		
<b>Section V – Administration</b>		
<i>Section 5000 – Administrative Procedures</i>	5001 – 5022	5001 – 5022
<hr/>		
<b>Section IX – Professional Issues Task Force</b>	---	Tab marked "IX Professional Issues Task Force"
	---	Table of Contents
<i>Section 9000 – Objectives, Organization, and         Operations</i>	---	Tab marked "SECPS 9000 Objectives, Organiza- tion, and Operations"
	---	9001 – 9004
<hr/>		
<b>Last Update Letter</b>	---	<b>Update Letter No. 5</b>
<hr/>		



November 1993

To the Managing Partners of SEC  
Practice Section Member Firms

***Update No. 4 to the SEC Practice Section Reference Manual***

Enclosed is the update to the *SEC Practice Section Reference Manual*. Separate filing instructions are enclosed.

The following is a description of the major changes reflected in these materials:

- The peer review standards were revised to require at least one audit of a federally insured depository institution with more than \$500 million in total assets be included in the scope of the review if the review is intended to satisfy the requirements of Section 36 to the Federal Deposit Insurance Act. In addition, a footnote was added to clarify that the reports on internal control and compliance with laws and regulations issued on such engagements should be reviewed if the audit engagement is selected for review.
- The peer review standards were revised to specify that the review team should review the documentation supporting the action taken by a reviewed firm on an engagement reviewed during the course of the peer review for which the reviewed firm concluded that it had failed to reach an appropriate conclusion on the application of professional standards (AU Sections 561 and 390 and AR Section 100.42) if such action is taken prior to issuance of the peer review report. If the corrective action is not taken prior to issuance of the report, the Peer Review Committee may require the firm to permit the review team to review the corrective action when it is completed as a condition of acceptance of the peer review documents.
- The peer review standards were revised to allow the Peer Review Committee to have input on the materials submitted by a member firm to the AICPA Professional Ethics Division when the Committee requires the member firm to refer a matter to the Professional Ethics Division because the firm disagrees with the Committee on the resolution of a technical matter.

- The exhibit to the peer review standards that flowcharts the review of engagements was expanded to clarify the reviewer's responsibility to review the corrective action taken by a reviewed firm on an engagement reviewed during the course of the peer review for which the reviewed firm concluded that it had failed to reach an appropriate conclusion on the application of professional standards (AU Sections 561 and 390 and AR Section 100.42).
- The "Guidelines for and Illustrations of the Letter of Comments" was revised to add two new illustrative findings and an appendix on determining whether a finding also appeared in the report and letter of comments issued in connection with the firm's prior peer review.
- Footnote one to the "Interpretations of the Quality Control Standards" was revised to conform with the Peer Review Committee's recently changed guidelines on when to modify a peer review report for failure to perform an inspection.
- The "Administrative Procedures of the Peer Review Committee" section was revised to allow for the retention of administrative documents related to the scheduling of a peer review until the next review or until the time for such review has elapsed.
- A footnote was added to the "Administrative Procedures of the Peer Review Committee" section stating that, if the peer review is intended to satisfy the requirements of Section 36 to the Federal Deposit Insurance Act, the peer review working papers should be retained for 120 days after the date the reviewed firm files the peer review documents with the Federal Deposit Insurance Corporation.
- The 1994 dues schedule was revised by the executive committee.

Please write to us if you have any questions about this update.

Sincerely,



R. Bruce Brasell, CPA  
Senior Technical Manager  
Quality Review Division

Enclosures

**Instructions for Filing Update No. 4 to the  
SEC Practice Section Reference Manual**

The following materials in the loose-leaf manual should be removed and replaced in accordance with the filing instructions below.

<b>SEC Practice Section Reference Manual</b>	<b><u>Pages to Remove</u></b>	<b><u>Pages to Insert</u></b>
	Title page/ copyright page	Title page/ copyright page
<b>Section I – SEC Practice Section (SECPS)</b>		
<i>Section 1000 – Organizational Structure and Functions</i>	1035 – 1036	1035 – 1036
<b>Section II – Peer Review Program Standards</b>		
<i>Section 2000 – Standards for Performing and Reporting on Peer Reviews</i>	2001 – 2002	2001 – 2002
	2013 – 2044	2013 – 2044-1
	2047 – 2048	2047 – 2048-2
<i>Section 2200 – Writing Letters of Comments</i>	2201 – 2202	2201 – 2202
	2227 – 2253	2227 – 2256
<i>Section 2300 – Writing Letters of Response</i>	2305 – 2308	2305 – 2308
<b>Section V – Administration</b>		
<i>Section 5000 – Administrative Procedures</i>	5001 – 5021	5001 – 5022
<b>Appendixes</b>		
<i>Appendix B – Interpretations of Quality Control Standards</i>	10,013 – 10,014	10,013 – 10,014
<b>Last Update Letter</b>		<b>Update Letter No. 4</b>



## Division for CPA Firms

American Institute of Certified Public Accountants

Harborside Financial Center  
201 Plaza III  
Jersey City, NJ 07311-3881  
(201) 938-3030 Facsimile: (201) 938-3056

December 1992

To the Managing Partners of SEC  
Practice Section Member Firms

### *Update No. 3 to the SEC Practice Section Reference Manual*

Enclosed are the updates to the *SEC Practice Section Reference Manual*. Separate filing instructions are enclosed.

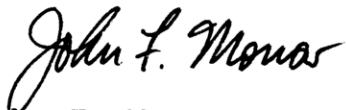
The following is a description of the major changes reflected in these materials:

- The peer review standards effective for peer reviews performed before April 1, 1993 have been deleted from the manual.
- The peer review standards were revised to require that a team captain attend a peer review training course after 1991 and within five years of the commencement of the review. Both the introductory AICPA reviewer training course titled "How to Conduct a Review Under the AICPA Practice Monitoring Programs," and the advanced AICPA reviewer training course titled "Current Issues in Practice Monitoring" fulfill this requirement.
- An exhibit was added to the peer review standards that flowcharts the risk-based approach for selecting offices and engagements for review.
- An appendix was added to the "Administrative Procedures of the Peer Review Committee" defining the reviewer's responsibilities when performing a review, and the types of corrective or monitoring actions that may be imposed on reviewers as a result of deficient performance on peer reviews.

- The "Guidelines for Involvement by Associations of CPA Firms" were revised to indicate that associations of CPA firms arranging and carrying out reviews have a responsibility to establish policies and procedures for ensuring that reviews are carried out in a manner consistent with the SECPS peer review standards.
- The organizational document of the *SEC Practice Section Reference Manual* has been revised by the SECPS executive committee to incorporate changes in certain administrative procedures.
- The SECPS executive committee amended the "Continuing Professional Education Requirements" to conform with the *Statement on Standards of Formal Continuing Professional Education (CPE) Programs* of the AICPA, concerning programs qualifying for CPE credit.
- The 1993 dues schedule was revised by the executive committee.

Please write to us if you have any questions about this update.

Sincerely,



John F. Morrow, CPA  
Director  
Peer Review Programs

Enclosures



## Instructions for Filing Update No. 3 to the SEC Practice Section Reference Manual

The following materials in the loose-leaf manual should be removed and replaced in accordance with the filing instructions below.

<b>SEC Practice Section Reference Manual</b>	<b><u>Pages to Remove</u></b> Title page/ copyright page	<b><u>Pages to Insert</u></b> Title page/ copyright page
<b>Section I - SEC Practice Section (SECPS)</b>		
<i>Section 1000 - Organizational Structure and Functions</i>	1001 - 1036	1001 - 1036
<b>Section II - Peer Review Program Standards</b>		
<i>Section 2000 - Standards for Performing and Reporting on Peer Reviews</i>	Table of Contents Cover page/Notice to Readers 2001 - 2055 Tab: "EFF. 4/1/93" 2003 - 2006 2009 - 2010 2015 - 2018 2023 - 2026 2031 - 2034 2049 - 2059	Table of Contents --- --- --- 2003 - 2006 2009 - 2010 2015 - 2018 2023 - 2026 2031 - 2034 2049 - 2062
<i>Section 2300 - Writing Letters of Response</i>	2303 - 2304	2303 - 2304
<i>Section 2400 - Reviews of Quality Control Materials</i>	2407 - 2410	2407 - 2410
<i>Section 2500 - Reviews of Continuing Professional Education Programs</i>	2503 - 2504	2503 - 2504
<b>Section III - Associations</b>		
<i>Section 3000 - Guidelines for Association Involvement</i>	3003 - 3004	3003 - 3004
<b>Section V - Administration</b>		
<i>Section 5000 - Administrative Procedures</i>	5001 - 5021	5001 - 5021
<b>Section VII - Quality Control Inquiry Committee</b>		
<i>Section 7000 - Objectives, Organization, and Operations</i>	7009 - 7010	7009 - 7010
<b>Section VIII - Continuing Professional Education</b>		
<i>Section 8000 - Membership Requirements</i>	8001 - 8019	8001 - 8014
<i>Last Update Letter</i>		<i>Update Letter No. 3</i>



## Division for CPA Firms

American Institute of Certified Public Accountants

1211 Avenue of the Americas  
New York, N.Y. 10036-8775  
(212) 575-6200  
Facsimile: (212) 575-3846

April 1992

To the Managing Partners of SEC  
Practice Section Member Firms

### Update No. 2 to the SEC Practice Section Reference Manual

Enclosed are the updates to the SEC Practice Section Reference Manual. Separate filing instructions are enclosed.

The following is a description of the major changes reflected in these materials:

- o The peer review standards were revised to reflect a risk-based approach for selecting offices and engagements for review. This change will be effective for peer reviews performed on or after April 1, 1993, but earlier implementation is encouraged. An additional section 2000 is included in this package which incorporates the revised standards.
- o Effective April 1, 1993, the peer review standards require that a team captain attend a peer review training course in 1992 or later. Both the introductory AICPA training course titled "How to Conduct a Review Under the AICPA Practice-Monitoring Programs," and the advanced AICPA course titled "Current Issues in Practice-Monitoring" will fulfill this requirement.
- o The peer review standards were revised to require that a team captain attend the firm-wide exit conference and interact with the reviewed firm and review team during the conduct of the review.
- o A new "Guidelines for and Illustrations of the Letter of Comments" section was developed by the PCPS and SECPS Peer Review Committees and the AICPA Quality Review Executive Committee to further assist reviewers in preparing an effective letter of comments.

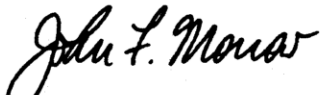
018023

SECPS Member Firms  
April 1992  
Page 2

- o The peer review working paper retention policies were revised to require that all working papers, reports, and letters prepared during an SECPS peer review be retained for ninety days after the date on which the SECPS peer review committee has accepted the peer review documents, unless the committee indicates that the working papers should be retained for a longer period of time.
- o The SECPS executive committee amended Appendix C, SECPS section 1000.36, "Timing of Peer Reviews," to require that firms previously enrolled in the PCPS or the AICPA Quality Review Program that did not have a review under those programs to begin their initial SECPS peer review by the date set under the previous program or ninety days after joining SECPS, whichever is later.

Please write to us if you have any questions about this update.

Sincerely,



John F. Morrow, CPA  
Director  
Peer Review Programs

Enclosures

Instructions for Filing Update No. 2 to the  
SEC Practice Section Reference Manual  
(Loose-leaf Edition)

The following materials in the loose-leaf manual should be removed and replaced with the contents of this package, according to the following filing instructions:

SECPS Section 1000  
Organizational Structure  
and Functions of the  
SEC Practice Section  
of the AICPA Division for  
CPA Firms

o Remove pages 1007 and 1008 and replace with the enclosed pages 1007 and 1008.

o Remove pages 1021 and 1022 and replace with the enclosed pages 1021 and 1022.

Section II  
SECPS Peer Review  
Program Standards

o Remove the Section II "Table of Contents" page (under the white tab) and replace with the enclosed Section II "Table of Contents."

SECPS Section 2000  
Standards for Performing  
and Reporting on  
Peer Reviews

o Remove pages 2007 through 2028 and replace with the enclosed pages 2007 through 2028.

o Remove pages 2037 and 2038 and replace with the enclosed pages 2037 and 2038.

Tab

o Insert enclosed tab "EFF. 4/1/93: Standards for Performing and Reporting on Peer Reviews" after page 2055.

o Insert enclosed Cover Page and pages 2001 through 2059 after tab "EFF. 4/1/93: Standards for Performing and Reporting on Peer Reviews."

SECPS Section 2200  
Writing Letters of  
Comments

o Remove pages 2201 through 2214 and replace with the enclosed pages 2201 through 2253.

**SECPS Section 5000**  
**Administrative Procedures**

o Remove pages 5007 through 5010 and replace with the enclosed pages 5007 through 5010.

o Remove pages 5015 through 5018 and replace with the enclosed pages 5015 through 5018.

**Last Update Letter**

o Insert enclosed tab "Last Update Letter" after page 10,042.

o Insert enclosed Update 2 Cover Letter and these instructions.