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

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# SECPS Section 1000

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

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## 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 firm’s 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.

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

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<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, o, and p.

<sup>4</sup> See Appendix G, SECPS §2000.149, "Interpretation: Alternative Partner Assignment Arrangements."

<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.

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 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
  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

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<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.

<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).

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.(10). 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—
    - (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 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 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

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

<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.

<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.



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 §1000.08g (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.

- o.* Ensure that the member firm has policies and procedures in place to comply with applicable independence requirements of the AICPA, SEC and Independence Standards Board.<sup>15</sup>
- p.* Ensure that the member firm has policies and procedures in place that in the event of litigation alleging deficiencies in the conduct of an audit of financial statements of a present or former SEC client,<sup>16</sup> will cause the firm to observe applicable guidelines of the Quality Control Inquiry Committee and the AICPA Professional Ethics Division.<sup>17</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.

### 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.

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<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, o and p.

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

<sup>16</sup> See Appendix D, SECPS §1000.38 “Definition of an SEC Engagement.”

<sup>17</sup> See Appendix M, SECPS §1000.47 “Procedures in Connection with an Alleged Audit Failure.”

## 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.

.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.
  - 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.

### 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
- 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.

## **.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.
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 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.

## **.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 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, 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.

## **.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, o and p, 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].
  - 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 §1000.08(k) 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.

### **.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.

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

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<sup>1</sup> 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."

<sup>2</sup> 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.

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 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;
- 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.

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<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.

<sup>4</sup> The SECPS Peer Review Committee may authorize alternative procedures when this requirement imposes an undue hardship on the firm. See SECPS §2000.148, 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.

<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.

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 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 subsequent event 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.

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<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*.

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

## **.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 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.

## **.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 resolving the matter, ordinarily will cause the Peer Review Committee to decide to conduct a hearing for the purpose of determining whether to recommend sanctions against the firm.



## **.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 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 firm's 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.

***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 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.

## **.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,

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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 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.

## **.44 APPENDIX J—SEC Practice Section Dues**

1. The Executive Committee of the SEC Practice Section established the following dues structure (effective January 1, 2001):

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 \$40 per CPA employed in the firm, and \$200 per SEC client. In any event, the firm's minimum annual dues assessment shall not be less than \$800 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 \$800 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.

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.

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<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, o and p.

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 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 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<sup>1</sup> must comply with the applicable 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 member firm’s commitment to the training of professionals on independence policies and the action taken in the case of non-compliance with such policies.

### Requirements

1. Each member firm shall establish written independence policies covering relationships with “restricted entities,” for example, relationships between the restricted entity and the member firm (including, where applicable, its foreign-associated firms<sup>2</sup>), its benefit plans, and its professionals. These policies shall be written in language, to the extent possible, that is clear, concise, and tailored to each member 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 relationships, proscribed services, and fee arrangements. For purpose of this membership requirement, “restricted entities” shall include all audit clients of the member firm, and to the extent applicable its foreign-associated firms, that are SEC registrants and other entities<sup>3</sup> that the member firm is required to be independent of under the applicable SEC requirements.
  - 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 the Securities Exchange Act of 1934 (“Exchange Act”); (2) a registrant that files periodic reports under the Investment Company Act of 1940 or the Exchange Act; (3) a bank or other lending institution that files periodic reports under the Exchange Act 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 Investment Company Act of 1940 or section 13 or 15(d) of the Exchange 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 Exchange Act that has securities registered or has filed a registration statement with the SEC.

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<sup>1</sup> For purposes of this requirement, *member firm*, unless otherwise noted, means the U.S. firm that is the member of the SEC Practice Section.

<sup>2</sup> For purposes of this requirement, a *foreign-associated firm* is an organization outside of the United States and its territories that would normally include only those organizations that are reported on the member firm’s annual report to the SECPS in accordance with §1000.08(n) and Appendix K of the SECPS Reference Manual, but could include other organizations based on facts and circumstances.

<sup>3</sup> For practical purposes, member firms may exclude entities whose securities are not available for public sale.



2. The member firm's independence policies shall be provided or otherwise made available to all professionals, as defined in paragraph 1(a). Substantive changes to the member firm's policies shall be provided or otherwise made available on a timely basis.
3. The member firm shall establish a training program to provide reasonable assurance that professionals understand the member firm's independence policies. 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 relationships, proscribed services and fee arrangements.
4. Each member firm shall maintain a database ("Restricted Entity List") that includes all restricted entities, as described in paragraph 1. The member firm's policies should explain why, when and how SEC registrant audit clients (and other related entities as discussed above) are to be placed on the Restricted Entity List. For member firms that provide an annual audit to more than 500 SEC registrants, an automated system to identify investment holdings of partners and managers that might impair independence is required. Member firms that provide an annual audit to more than 500 SEC registrants are required to have the automated system in place by December 31, 2000 or within a reasonable transition period upon achieving that number, not to exceed one year.
5. Each member firm shall designate a senior-level partner responsible for: (1) overseeing the adequate functioning of the independence policies of and the consultation process within the member firm; (2) providing or otherwise making the Restricted Entity List readily available to all professionals; (3) keeping the Restricted Entity List updated on at least a monthly basis; and (4) communicating additions to the Restricted Entity List on a timely basis (generally monthly).
6. Member firms that have foreign-associated firms shall provide or otherwise make available the member firm's independence policies, required in paragraph 1, and its Restricted Entity List, required in paragraph 4, to its foreign-associated firms, including the partners and managers therein. This may be accomplished directly by the member firm, by an international organization of which the member firm is a participating firm, or by a foreign-associated firm.
7. Each member firm's independence policies and procedures should specifically require the following:
  - a. Prior to obtaining any security or other financial interest in an entity, professionals should review the Restricted Entity List to determine whether the entity is included thereon. This review would also be required by the professional's spouse and 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 member firm's independence policies, (2) understands their applicability to his or her activities and those of his or her spouse and dependents, and (3) has complied with the requirements of the member 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 and the corrective action taken or proposed to be taken on a timely basis when identified. 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 subject to the independence rules of the ISB, SEC or AICPA.

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<sup>4</sup> The provisions of paragraph 7(b) are effective April 1, 2000 and shall be applied prospectively.

- d. Each member firm shall have a monitoring system under the supervision of the senior-level partner designated in 5. above to determine that adequate corrective steps are taken and documented on all apparent violations reported by professionals within the member firm. The monitoring system should include procedures to provide reasonable assurance that (i) investments of the member firm and its benefit plans are in compliance with the member firm's policies and (ii) information received from its partners and managers is complete and accurate . The monitoring system will generally include auditing, on a sample basis, selected information such as brokerage statements, or alternative procedures that accomplish the same objective.
- e. Each member firm shall develop as part of its policies, guidelines for actions to be taken against professionals for violations of independence. These policies will describe the potential sanctions to levy against those professionals for violating member firm policies and procedures or professional independence requirements .

### **Effective Date**

Unless otherwise stated, all requirements with respect to the member firm are effective December 31, 2000. All requirements with respect to a member firm's foreign-associated firms are effective January 1, 2002.

## **.47 APPENDIX M—Procedures In Connection With An Alleged Audit Failure**

### **Introduction**

**.01** Member firms must comply with the SECPS membership requirement described at SECPS §1000.08, which requires member firms to report to the Quality Control Inquiry Committee (“QCIC”) certain matters concerning alleged deficiencies in the conduct of an audit of the financial statements or reporting thereon of a present or former SEC client.<sup>1</sup> The importance of timely reporting by a member firm and subsequent inquiry and review by the QCIC is to ensure that identification and assessment of alleged audit and reporting deficiencies occurs quickly to enable the member firm to enhance or modify, if deemed necessary, its quality control system to minimize or eliminate future occurrences.

### **Requirements of SEC Practice Section Member Firms**

**.02** Member firms will continue to report to QCIC those incidents as described at §1000.08(k), and, at a minimum, will conduct the following procedure:

- The member firm, after the service of the complaint concerning matters as described in paragraph .01 above, will conduct a review of the engagement to evaluate the performance of senior engagement personnel with respect to the specific issues contained in the complaint against the firm or individuals. In the member firm’s meetings with the QCIC’s representatives, the member firm will be asked to represent that it has performed such a review.

**.03** The QCIC will review such matter, and if appropriate, will refer such matter to the AICPA Professional Ethics Division.<sup>2</sup> The Division will assess whether or not individual performance-specific issues warrant investigation. If the matter warrants investigation, the Division will inform the member firm that further consideration of the matter will be deferred in accordance with Division policy.<sup>3</sup>

**.04** Once the member firm and the audit engagement partner<sup>4</sup> on the work at issue in the investigation have been notified by the Division that the matter is being deferred the member firm must select one of the following options to apply to that partner during the period of the deferral, if the individual is still associated with the member firm:

- a. Terminate/retire the individual from the member firm.
- b. Remove that individual from performing or supervising audits of public companies until the Division’s ethics enforcement process is completed.
- c. Subject that individual to additional oversight on all public company audit engagements in which that individual is involved.<sup>5</sup> Additional oversight, for the purpose of this membership requirement, is defined to mean for at least one year, the individual will perform such audits subject to oversight by a senior technical partner appointed by the member firm’s Managing Partner/CEO. The senior technical partner oversight of such engagements, at a minimum, will meet the SEC Practice

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<sup>1</sup> See §1000.08(k) and §7000.11 of the *SEC Practice Section Reference Manual* for a description of other matters that a member firm is required to report to the Quality Control Inquiry Committee.

<sup>2</sup> See §7000.13 and §7000.26 of the *SEC Practice Section Reference Manual* for a description of the memorandum of understanding on cooperation and coordination between the Division and the QCIC. For a description of the SEC Access Agreement concerning such matters, refer to §7000.25 of the *SEC Practice Section Reference Manual*.

<sup>3</sup> See §7000.27 of the *SEC Practice Section Reference Manual* for the Division’s policy regarding deferral of such matters.

<sup>4</sup> This membership requirement is intended to apply to the audit engagement partner. However, in certain circumstances, this membership requirement may be applied to other senior engagement personnel as considered necessary by the member firm.

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

Section's concurring partner review membership requirement, which in these circumstances will include timely involvement in significant planning activities, the determination of risk assessments and the design of tests of controls and substantive audit procedures. Thereafter, the individual must remain under the additional oversight that the firm's Managing Partner/CEO determines, in light of that person's evaluation of the individual's performance, is necessary to protect the public interest.

.05 The member firm has the responsibility of deciding on the selection of one of the above options. The implementation of the option selected is subject to review in the member firm's peer review and by the Public Oversight Board.

### **Situations in Which the Individual is No Longer Associated with the Member Firm**

.06 Situations may occur in which the individual subject to the Division's investigation or the member firm's additional oversight leaves the member firm and becomes associated with another member firm. Any successor member firm, with which that individual becomes associated, is required to apply one of the options described at paragraph .04 to that individual.

### **Effective Date**

.07 The membership requirement described at 1000.08(p) and Appendix M is effective with respect to original complaints reported to the Quality Control Inquiry Committee after January 1, 2001.



# SECPS 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 (2001–2002)

Richard L. Miller, Chair  
Spencer A. Coates  
John C. Compton  
Albert R. Denny  
Arthur I. Farber  
Robert E. Fleming  
Bradley R. Gabosh  
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# SECPS Section 2000

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

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## 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. Formed by a member firm engaged by the firm under review (a firm-on-firm review).
- b. 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 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.

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

<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*.

## 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—

- 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 complying 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<sup>5</sup> 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>6</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 confidentiality.<sup>7</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>8</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.

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<sup>5</sup> The report also includes an attachment (SECPS §2100.33) entitled "Description of the Peer Review Process." Hereinafter, the report and the attachment are referred to as the report.

<sup>6</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.

<sup>7</sup> The AICPA maintains current information on states that do not clearly provide an exception to the confidentiality requirements discussed in this section.

<sup>8</sup> See Appendix A, SECPS §2000.144, "Interpretation: Independence, Integrity, and Objectivity," for additional guidance and examples of how the independence requirements are to be interpreted.

.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 the firms whose personnel participated in the reviewed firm's most recent peer review.<sup>9</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 arrangements with the same non-CPA entity<sup>10</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.

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<sup>9</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.

<sup>10</sup> Including all entities owned or controlled by a common parent company.

.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.

### **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 An 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>11</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 direc-

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<sup>11</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.)

tion, 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).

**.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 be-

fore accepting the engagement.<sup>12</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.

### **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.

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<sup>12</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.

**.41** Peer review risk consists of the following two parts:

- a. The risk (consisting of inherent risk<sup>13</sup> and control risk<sup>14</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 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>15</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.

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<sup>13</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>14</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.

<sup>15</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).



3. Review compliance with the membership requirements of 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 captain. (See Appendix B, SECPS §2000.145). 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 §2000.146). 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>16</sup>
  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).

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<sup>16</sup> See also Appendix H to SECPS §1000.42, "Illustrative Statement of Firm Philosophy."

- 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>17</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 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>18</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.
  11. The name and country of all foreign associated firms listed on the firm's SECPS annual report that have advised the firm by written representation that certain policies and procedures consistent with the objectives of Appendix K have been established (SECPS§ 1000.45).

(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, integrity, and objectivity; personnel management; ac-

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

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

ceptance 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 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 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 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>19</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.

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

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>20</sup> in each office reviewed (1) 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 that Act established by the *Federal Deposit Insurance Corporation Improvement Act of 1991*.<sup>21</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 (§2000.147) for a discussion of ways to achieve appropriate coverage of engagements without devoting unnecessary time to the review.

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<sup>20</sup> As defined in parts one and two of Appendix D, SECPS §1000.38, "Definition of an SEC Engagement."

<sup>21</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.



.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.
- 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>22</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.
- 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.

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<sup>22</sup> Instructions, checklists, and programs are included in the *SEC Practice Section Peer Review Program Manual* and should be considered for their applicability.

- 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, annual independence certifications 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>23</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 ac-

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<sup>23</sup> See the conclusions section of the engagement checklist contained in the *SEC Practice Section Peer Review Program Manual*.

counting 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 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>24</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 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.

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<sup>24</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").

### ***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 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 disposi-

tion. (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 2000.104-.115, and "Letter of Comments," SECPS §2000.116-.1121).

**.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 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 §2000.138, and Exhibit B, SECPS §2000.139).

**.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>25</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 the SEC Practice Section Peer Review Committee 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 and/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).

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<sup>25</sup> See "Retention Period" under "Review Team Working Papers," SECPS §5000.17-.20.

.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

### General Guidelines

.104 A review team should issue one the following types of reports:

- a. An unmodified report.
- b. A report modified due to one or more of the following:
  1. A quality control system design deficiency
  2. Noncompliance with quality control policies and procedures
  3. Noncompliance with membership requirements

.105 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. A statement indicating that firm has agreed to comply with the membership requirements of the Section.
- d. An indication that the review was performed in accordance with standards established by the Peer Review Committee of the Section.
- e. A reference to the description of the peer review process, which should be attached to the report.
- f. A statement indicating that the review would not necessarily disclose all weaknesses in the system of quality control of all instances of lack of compliance with it or with the membership of the Section.
- g. An 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 complied with during the year reviewed to provide the firm with reasonable assurance of complying with professional standards.
- h. An opinion on whether the reviewed firm complied with the membership requirements of the Section in all material respects and, if not, a description of the reasons for modification.
- i. If applicable, the reason(s) for a modified report. The reasons should include a description of the deficiency(ies) and the reviewing firm's recommendation.
- j. A reference to the letter of comments, if such a letter was issued.
- k. An attachment which describes the peer review process, including an overview and information on planning and performing the review.

.106 A review team may issue a modified or an unmodified report.<sup>26</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:

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<sup>26</sup> The term **modified report** includes a modified or an adverse opinion. Deficiencies leading to a modified or adverse opinion and the reviewing firms recommendations should be included in the report and not repeated in the letter of comments.

- 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 complying 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 complying with professional standards.
- c. Whether the reviewed firm complied with the membership requirements of the Section in all material respects.

.107 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***

.108 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.

.109 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.

.110 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 complying 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.

.111 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***

.112 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 complying 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.

.113 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 non-compliance 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 compliance with professional standards. The more direct the relationship between a specific quality control policy or procedure and the application of professional standards, the higher the degree of compliance should have been to warrant the issuance of an unmodified report.

.114 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 complying 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 complying 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 complying with professional standards.<sup>27</sup>

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

.115 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**

.116 The review team ordinarily will issue a letter of comments (letter) concurrently with its report, unless the opinion is adverse. The major objectives of the letter are to report matters that the review team believes resulted in conditions being created in which there was more than a remote possibility that the firm would not comply with professional standards and, if appropriate, to set forth recommendations regarding those matters.<sup>28</sup> A letter of comments should not be prepared when an adverse report is issued as all deficiencies, comments and recommendations should be contained in the report.

#### ***Contents of the Letter***

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

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<sup>27</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 §2000.116-.121).

<sup>28</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 "the chance of the future event or events occurring is slight."



- a. A reference to the report and an indication if it was modified.
- b. A statement that the matters described in the letter were not considered to be of sufficient significance to affect the opinion expressed in the report.
- c. The reviewer's comments and recommendations.

**.118** Deficiencies leading to a modified or adverse opinion and the reviewing firm's recommendations should be included in the report and not repeated in the letter of comments.

**.119** If any of the matters to be included in the report or letter were included in the report or 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.

**.120** 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***

**.121** The letter should include 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 comply with professional standards, even though the firm had reasonable assurance of complying 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 noncompliance 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>29</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 comply 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 §2000.112-.115).
  1. In assessing whether the degree of noncompliance created such a condition, the review team should consider the nature, causes, pattern, and pervasiveness of the instances of noncompliance noted, as well as the implications for the firm's 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 compliance 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

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<sup>29</sup> *Noncompliance 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.

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 noncompliance 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.
- 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

.122 The reviewed firm is required to respond in writing to the review team's comments on matters in the report and/or 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 report and/or 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

.123 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.

.124 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

.125 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

**.126** 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 the report and/or 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.

**.127** 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.

**.128** 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.
- b. Requesting the review team to revise the report or the letter of comments.<sup>30</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.

**.129** If further inquiry or action is initiated, a Committee member may be assigned to follow the matter until it is concluded.

**.130** Ordinarily, except when adverse, 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.

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<sup>30</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 a future Committee meeting.

- 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 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.

.131 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 report and/or 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.

.132 If no additional actions are deemed necessary, the report, the letter of comments, and the reviewed firm's response to the report and/or the letter of comments 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.)

.133 In unusual circumstances, the Committee may deem it appropriate to place in the public files reports, letters of comments, and responses to the report and/or the letters by reviewed firms before they have been accepted. In such circumstances, the public file is supplemented with a memorandum stating that further inquiry has been initiated or describing the actions.

### **Disagreement Between Committee and Review Team**

.134 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.

.135 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.

.136 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**

.137 The provisions of these Standards are applicable to peer reviews on firm's system of quality control for its accounting and auditing practice for reports dated on or after June 30, 2001.

# SECPS Section 2400

## *Standards for Performing and Reporting on Reviews of Quality Control Materials*

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## 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.
- 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

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<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.



- 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 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 QCM Reviews

### Qualifications for Serving as QCM Reviewers

**.09** A QCM review may be performed 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 §2000.32-.34. A member firm serving as a QCM reviewer must adhere to the guidelines included in “Qualifications for a Reviewing Firm” in SECPS §2000.35-.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 QCM Reviews

**.11** The provider should identify the materials to be reviewed and on which an opinion is to be expressed. A QCM review should include a study and evaluation of the system for the development and maintenance of the quality control materials that have been identified and a review of the materials themselves.

**.12** A study and evaluation of the system for the development and maintenance of quality control materials normally should include the following procedures:

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<sup>3</sup> See Appendix A—“Interpretation: Association Quality Control Materials,” SECPS §3000.09.

- a. Reviewing and evaluating the procedures established for developing quality control materials
- b. Reviewing and evaluating the procedures established for updating (including distributing) the quality control materials to assure that the materials remain current and relevant when the provider has undertaken the responsibility for updating the materials
- c. Reviewing the technical competence of the developer(s)/updater(s) of the quality control materials
- d. Obtaining evidence that the quality control materials were reviewed for technical accuracy by qualified person(s) other than the developer(s)/updater(s)
- e. Determining whether the provider has appropriately communicated its policy regarding the period covered by the materials, the professional standards the materials purport to encompass, and the provider's intention to update the materials
- f. Reviewing the system developed for soliciting and evaluating feedback from users of the quality control materials

.13 A QCM review team should review the resultant quality control materials, to the extent deemed necessary, to evaluate whether the materials are reliable aids in conforming with those professional standards the materials purport to encompass.

## Standards for Reporting on QCM Reviews

### The Review Team's Report

.14 Within thirty days of the date of the exit conference, the QCM review team should furnish the provider with a written report and, if applicable, a letter of comments.<sup>4</sup>

### 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.

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<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 §2000.92-.93.

## 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, 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.

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<sup>5</sup> For guidance on evaluating whether a matter should be included in a letter of comments, see SECPS §2000.120-.121.

.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.



## .35 APPENDIX A—Peer Review Fees

### Administrative Fees

- 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 another firm (a “Firm-on-Firm” review) or under the auspices of an association of CPA firms.
- 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

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<sup>1</sup> A separate scheduling and evaluation fee will be charged for each set of peer review documents submitted, including plans of administration.

## **.36 APPENDIX B—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:

- Attendance at a reviewer’s training course and receipt of a satisfactory evaluation from the instructor of the course.
- Committee oversight on the next review performed by the reviewer at the expense of the reviewer’s firm (including out-of-pocket expenses, such as travel cost, and per diem charges at the respective billing rates established by the Section).
- Completion of all outstanding reviews before accepting an engagement to perform another review.
- Preissuance review of the report, letter of comments, and working papers on future reviews by an individual who has experience in performing peer reviews.

If corrective or monitoring actions are imposed on a reviewer by the 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 SECPS staff 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.

# SECPS Section 6000

## *Peer Review Committee Meeting and Voting Procedures*

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## 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 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 acknowledgment 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.

## **.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.

# SECPS Section 7000

## *Objectives, Organization, and Operations of the Quality Control Inquiry Committee*

### NOTICE TO READERS

This section, entitled “Objectives, Organization, and Operations of the Quality Control Inquiry Committee” was approved by the Executive Committee of the SEC Practice Section of the AICPA Division for CPA Firms on September 13, 1984, and was subsequently amended on April 21, 1987 and on September 26, 2000.

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## Objectives

**.01** As one important arm of the SEC Practice Section (the “Section”), the Quality Control Inquiry Committee’s primary objective is to “improve the quality of practice of CPA firms before the Securities and Exchange Commission.”

**.02** Deficiencies in the conduct of an audit or reporting thereon—commonly referred to as “audit failures”—are often the result of isolated instances of misunderstanding of instructions, mistakes of judgment, carelessness, or other personnel 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.

**.03** However, some audit deficiencies can indicate a weakness in a firm’s quality control system or in its compliance with that system, and some litigation can indicate the need for changes in generally accepted auditing standards, generally accepted accounting principles, independence standards, quality control standards or membership requirements. 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 and may require a firm to take corrective actions or require a change in professional standards.

**.04** In recognition of the significant public interest in identifying possible improvements in a firm’s quality control system or in professional standards, the Quality Control Inquiry Committee (the “QCIC”)<sup>1</sup> was established by the Executive Committee of the SEC Practice Section in 1979 to make such inquiries as it considers necessary to determine, on a timely basis, whether facts relating to specific alleged audit failures indicate a possible need for corrective actions by the member firm involved or indicate that changes in generally accepted auditing standards, generally accepted accounting principles, independence standards, quality control standards or membership requirements need to be considered, and to recommend to the Executive Committee sanctions when deemed appropriate. In carrying out these responsibilities, the QCIC is governed by the provisions herein.

**.05** The QCIC’s mission does not involve a determination of whether an audit failure occurred. 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. While carrying out its responsibilities, the QCIC shall recognize that substantial prejudice can accrue as a result of its inquiries 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.

**.06** The alleged audit deficiencies that shall occasion the QCIC’s consideration are those that are required to be reported to the QCIC pursuant to §7000.11 hereof.

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<sup>1</sup> On December 6, 1988, the Executive Committee changed the name from the Special Investigations Committee to the Quality Control Inquiry Committee.



## Organization

- .07** The QCIC structure and procedures shall be as follows:
- a. The QCIC shall be composed of at least nine members who are partners or retired partners of member firms. Two QCIC members associated with a member firm may serve on the QCIC concurrently provided no more than one is active with that firm. QCIC members shall be appointed by the Executive Committee, which shall also designate one member as the Chairman.
  - b. Each QCIC member shall be initially appointed for a one-year term.
  - c. Members of the QCIC 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 QCIC member shall not serve concurrently as a member of either the Executive Committee or the Peer Review Committee of the Section.
  - e. A majority of the QCIC must be present to constitute a quorum. All decisions are to be made by a majority of those eligible to vote.
  - f. A member of the QCIC shall not take part in deliberations with respect to the member's firm or any other firm with respect to which the QCIC or the member believes there is a conflict of interest. A member of the QCIC shall also not engage in expert witness engagements involving audit firms. The QCIC shall establish guidelines for determination of conflicts of interest for this purpose.
  - g. The meetings and procedures of the QCIC and any of its task forces and all related information available to the QCIC and any of its task forces shall be treated as confidential, except as indicated in sections (h) and (i), below.
  - h. The QCIC'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 ("POB") and its staff on a confidential basis.
  - i. When the QCIC closes its files on a case, the QCIC's staff prepares a closed case summary on the matter that, together with such memoranda and checklists prepared by the staff of the POB to summarize its oversight activities, will be made available for reading by the staff of the Securities and Exchange Commission. Such closed case summaries, checklists and memoranda are not to be retained for more than thirty days from the date the SEC staff is notified the closed case is available for review. Once the SEC staff has reviewed such closed case summaries, checklists and memoranda, or if the thirty day period has passed, whichever occurs first, such information no longer needs to be retained and therefore shall be immediately destroyed. (See Appendix B, §7000.25)

**.08** The QCIC may adopt operating guidelines or procedures that are consistent with the provisions herein, subject to the approval of the Executive Committee.

**.09** The QCIC shall request from the SECPS Executive Committee whatever staff it needs to perform its functions.

## Operations

### Information to be Reported to the QCIC

**.10** SEC Practice Section member firms should report to the QCIC the information specified in §1000.08k.

.11 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, §7000.24, and (c) other matters added to the QCIC’s agenda at the request of the Executive Committee.

.12 The procedures for reporting cases by each firm shall be reviewed in the peer reviews. Also, the QCIC’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.

### **Coordination with the Professional Ethics Executive Committee**

.13 The Section’s Executive Committee has approved a memorandum of understanding on cooperation and coordination between the AICPA Professional Ethics Executive Committee and the QCIC (See Appendix C, §7000.26). 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 Executive Committee has jurisdiction over individual members of the AICPA with respect to the AICPA Code of Professional Conduct (See Appendix D, §7000.27 regarding the deferral of an AICPA Professional Ethics Executive Committee investigation due to related litigation or regulatory proceeding).

### **Procedures**

.14 To achieve the objectives set for it by the Executive Committee, the QCIC 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 corrective actions by the firm are necessary or (b) that changes in generally accepted auditing standards, generally accepted accounting principles, independence standards, quality control standards or membership requirements should be considered.

.15 The procedures performed by the QCIC or on its behalf to achieve those objectives are presented in Appendix E, §7000.28, “Framework for the Evaluation Process of the Quality Control Inquiry Committee.”

.16 A firm is required to cooperate with the QCIC by furnishing on a timely basis, upon request, the information contemplated in Appendix E, §7000.28 and by authorizing its peer reviewers to comply with requests for such information. A firm is not required to provide the QCIC 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.

.17 The procedures described in Appendix E, §7000.28 shall be undertaken expeditiously.

.18 A decision by the QCIC to close its files on a case does not relieve a firm of its obligation to report additional litigation, proceedings or investigations, within thirty days of their occurrence. Based on its evaluation of such reports, the QCIC may decide to reopen its files on the case.

.19 Before a motion to order corrective actions of a member firm (see Appendix E, Section 5b, §7000.28) is put to a vote, the firm shall be given the opportunity to attend a meeting of the QCIC to hear the reasons offered in support of the motion, to present its views on the matter, pose questions and to respond to questions by members of the QCIC. The firm shall be excused from the meeting before the QCIC votes on the motion. Firms are required to comply with the QCIC’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

.20 If a firm refuses to cooperate in providing information to the QCIC, refuses to take corrective actions ordered by the QCIC or to pay for the cost of such actions, such refusal or failure shall constitute a basis on which the QCIC 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 Statement of Policy on the Imposition of Sanctions (this document can be obtained from the staff of the SEC Practice Section upon request). The types of sanctions that may be recommended are described in §1000.29.

.21 The results of the QCIC's procedures, including any corrective actions ordered by the QCIC, 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 QCIC 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 peer review, and for continuing professional education, such circumstances are expected to be encountered rarely, if at all.

## Communications and Reports

.22 The QCIC shall submit periodic reports to the Executive Committee concerning cases on its agenda, in accordance with guidelines established by the Executive Committee.

.23 The QCIC shall promptly communicate with the Executive Committee, Peer Review Committee, Professional Issues Task Force, AICPA's Auditing Standards Board, AICPA's Accounting Standards Executive Committee, Financial Accounting Standards Board, Emerging Issues Task Force, Independence Standards Boards, or other appropriate professional committees, as appropriate, when it believes there is a need to assess the adequacy of generally accepted auditing standards, generally accepted accounting principles, quality control standards, independence standards, membership requirements, or other relevant AICPA guidance material. Such communications shall be made without reference to specific cases on the QCIC's agenda.

## **.24 APPENDIX A—Guidelines for the Consideration of Non-Reportable Matters Involving Regulated Financial Institutions**

Agreement adopted by the Executive Committee of the SEC Practice Section at their meeting on June 27, 1989.

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, §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.)

## **.25 APPENDIX B—SEC Access Agreement**

Agreement adopted by the Executive Committee of the SEC Practice Section at their meeting on September 12, 1995.

The purpose of this memorandum is to set forth the procedures used to implement the agreement entered into by the Securities and Exchange Commission (“SEC”), the Quality Control Inquiry Committee (“QCIC”), the Executive Committee of the SEC Practice Section (“Section”) of the American Institute of Certified Public Accountants (“AICPA”) and the Public Oversight Board (“POB”) to enable the SEC to make its own evaluation of the adequacy of the Section’s QCIC program and the effectiveness of the POB’s monitoring of that program. Under the agreement, the staff of the Office of the Chief Accountant of the SEC is to have access to QCIC documentation prepared exclusively for the use of the SEC.

This memorandum describes the documentation to which the SEC staff is to have access and the administrative procedures to be followed to facilitate such access.

### **Basis of Agreement**

The following general principles underlie the agreements reached by the parties concerned and serve as a basis for responsibilities assumed by each party and as a basis for determining procedures to be followed:

1. The SEC staff will have access to closed case summaries prepared by the QCIC staff pertaining to matters involving SEC registrants and reported to the committee. The SEC staff will have access to the POB’s *Program for Oversight of QCIC Cases* and meeting memoranda prepared by the POB staff documenting their oversight of matters involving SEC registrants considered by the QCIC.
2. The Section reserves the right to delay SEC access to QCIC information when there is an active adversarial proceeding on the specific case involving the SEC and the member firm. The SEC will be advised of such circumstances.
3. The SEC staff will not retain or make copies of any QCIC documentation reviewed, including POB programs and memoranda.

### **Information to be Provided to SEC Staff**

#### **Prior to Commencement of SEC Staff Review**

The POB staff will furnish to the SEC staff, prior to commencement of the SEC’s staff review of QCIC documentation, the Appendix setting forth the mission of the QCIC and the four phases of QCIC activities.

#### **Questions Raised by SEC Staff**

Questions raised by the SEC staff are generally to be directed to the POB or QCIC staff members. If additional information is required to respond to questions raised, the QCIC staff will forward the questions to the appropriate parties and either the POB or QCIC staff will subsequently respond to the SEC staff.

## **Timing of SEC Staff Review and Destruction of QCIC Documentation**

The SEC staff ordinarily will be expected to complete its inspection of information related to closed cases within thirty days from the date that the SEC staff is notified such information is available for review. Immediately thereafter, closed case summaries shall be discarded.

This informal memorandum of understanding will be reviewed periodically to determine whether it should be revised and continued or terminated.

## **.26 APPENDIX C—Memorandum of Understanding on Cooperation and Coordination between the AICPA Professional Ethics Executive Committee and the Quality Control Inquiry Committee of the SEC Practice Section**

Memorandum approved by the Executive Committee of the SEC Practice Section and the Executive Committee of the Professional Ethics Division at their meetings on May 22, 2001 and May 31, 2001, respectively.

The Quality Control Inquiry Committee (“QCIC”) of the SEC Practice Section evaluates certain matters concerning alleged deficiencies in the conduct of an audit by a member firm of the financial statements or reporting thereon of a present or former SEC client. The QCIC’s objectives in evaluating such matters are to determine, on a timely basis, whether facts relating to specific alleged audit failures indicate a possible need for corrective actions by the member firm involved or indicate that changes in generally accepted auditing standards, generally accepted accounting principles, independence standards, quality control standards or membership requirements need to be considered. For a more complete description of the QCIC’s objectives, see §7000.01-.06 of the SEC Practice Section Reference Manual (the “Reference Manual”).

Under the bylaws of the AICPA, the Professional Ethics Executive Committee (“PEEC”) has the responsibility, among other things, to enforce the Code of Professional Conduct and only PEEC has jurisdiction over individual members of the AICPA with respect to the Code of Professional Conduct and interpretations and rulings thereof.

The QCIC and the PEEC, recognizing that it is in the public interest for each to cooperate with the other to minimize duplication of effort both on their part and on the part of CPA firms and members that may be the subject of disciplinary proceedings, have agreed to this Memorandum of Understanding setting forth policies and procedures to govern cooperation and coordination between them.

- I. Proceedings by the QCIC and by the PEEC related to the same case ordinarily are not to be conducted concurrently, and the PEEC will defer any investigation of its own while a matter is on the agenda of the QCIC. The information to be reported to the QCIC is outlined in §7000.10-.12 of the Reference Manual.
- II. With respect to the cases discussed in Section I above, the QCIC prepares a Closed Case Summary for each case at the conclusion of its deliberations, in accordance with Section 7000.07 (i) of the Reference Manual. In addition, to avoid duplication of efforts in the conduct of investigations, the QCIC will make a determination from among the following four results:
  1. The case was deemed to be frivolous and the QCIC recommends that no actions be taken by the PEEC with respect to the engagement personnel.
  2. The QCIC determined that no engagement personnel issues of significance were involved in the case and recommends that no actions be taken by the PEEC with respect to the engagement personnel.
  3. The QCIC believes that there may be engagement personnel issues of significance, and recommends that the PEEC should determine whether or not to open an investigation of certain engagement personnel.
  4. The QCIC recommends that the PEEC open an investigation of certain engagement personnel.

The QCIC will inform the PEEC of the determination made, which it is anticipated that the PEEC will accept.

- III. With respect to those circumstances outlined in Section II. 3 above, whereby the PEEC will make a determination whether or not to open an investigation of certain engagement personnel, the QCIC will make available to the PEEC the complaint and related financial statements (collectively referred to as “public information”). The QCIC also will make available to the PEEC the Closed Case Summary, but only after prior approval from the member firm.

If the member firm agrees to make the Closed Case Summary available, the QCIC will schedule a meeting with the PEEC, or a task force thereof, at which time the PEEC will review the Closed Case Summary. The PEEC, or task force thereof, may not take notes on information contained in the Closed Case Summary, except for that which is public information. The Closed Case Summary will be retained by the QCIC for not more than thirty days from the date that the SEC staff is notified the Closed Case Summary is available for review.

If the member firm does not agree to make available to the PEEC the Closed Case Summary, the PEEC ordinarily will open an investigation. In either case, the decision to open an investigation will be made by the PEEC.

- IV. With respect to those circumstances outlined in Section II. 4 above, whereby the QCIC recommends that the PEEC open their own investigation of certain engagement personnel, the QCIC will make available to the PEEC the public information related to that case.



## **.27 APPENDIX D—Deferral of An Ethics Investigation Due to Related Litigation or Regulatory Proceeding**

The following excerpt is from the Joint Ethics Enforcement Program (JEEP) Manual of Procedures, dated October 1997. (A complete JEEP Manual of Procedures can be obtained from the AICPA Professional Ethics Division.)

**3.31** An investigation by an ethics committee of issues that are concurrently the subject of (a) a formal legal proceeding pending before a state or federal civil or criminal court, (b) a formal proceeding or investigation by a state or federal regulatory agency (for example, a state board of accountancy or the U. S. Securities and Exchange Commission) and/or (c) a formal appeal actually undertaken from a decision of a state or federal civil or criminal court or regulatory agency may unfairly prejudice the litigation position of a respondent. Accordingly a letter of inquiry to a firm and an opening letter to a respondent must include the following paragraph:

“The (named) committee will, if you so request, defer this investigation provided it receives a written request to do so accompanied by evidence that the issues and parties involved in the investigation are currently the subject of: (1) a legal proceeding before a state or federal civil or criminal court, (2) a proceeding or investigation by a state or federal regulatory agency (e.g., a State Board of Accountancy, U.S. Securities and Exchange Commission), and/or (3) an appeal actually undertaken from a decision of a state or federal civil or criminal court or regulatory agency. This investigation will be resumed at the conclusion of the proceeding, investigation, or appeal. You will receive periodic inquiries from ethics division staff requesting information about the status of such proceeding, investigation, or appeal.”

The letter of inquiry to the firm and the opening letter should also state that if the persons responsible for the engagement under investigation are no longer with the firm or no longer have control over the documents necessary to the investigation, e.g. financial statements, workpapers, litigation documents, correspondence, memoranda, the firm should designate a partner of the firm to assume responsibility for preservation and presentation of the above described documents. The designated partner should be an AICPA and/or state society member and must have sufficient authority within the firm to assure the retention and presentation of the described documents. That partner’s failure to fulfill this responsibility will be considered a violation of Rule 501—Acts Discreditable of the AICPA’s Code of Professional Conduct and/or a violation of AICPA bylaw 7.4.6. (and/or similar provisions of the state society code or bylaws).

**3.32** In certain unusual situations (e.g., where the threat of litigation is present or where an accounting firm has prevailed in defense of a complaint against it but continues in the litigation as a counter-claimant or other third-party plaintiff) litigation deferral may be granted if appropriate under all the circumstances involved and if evidence is presented to the ethics committee regarding the existence of the litigation.

**3.33** If the documentation submitted by the firm or respondent does not support his or her claim that the issues under investigation are the same as those involved in the litigation or proceeding, deferral of the ethics investigation should not be granted.

**3.34** During the period in which an investigation is deferred, the committee conducting the investigation should at least every six months send written inquiries to the respondents and/or the person named by the firm to preserve and present documents related to the investigation requesting information about the status of the proceeding, investigation, or appeal. The name of the court or agency and the docket number of the case should also be obtained. After the investigation has been deferred for five years, the written inquiry letter should be modified to request evidence that the matter that gave rise to the deferral is being actively pursued. In a situation where it appears that the matter is not being actively pursued, an ethics committee may consider removing an investigation from deferral status. If a satisfactory response is not received within 30 days of the date of such an inquiry, a letter of non-cooperation due to failure to cooperate should be sent certified mail-return receipt requested. The investigation should be resumed promptly when the proceeding, investigation, and/or appeal is completed.

## **.28 APPENDIX E—Framework for the Evaluation Process of the Quality Control Inquiry Committee**

1. This framework recognizes the importance of the Quality Control Inquiry Committee to the self-regulatory process and explicitly recognizes that the QCIC may request a member firm to undertake corrective actions in connection with any case reported to it unless circumstances or other procedures allow the QCIC to conclude that such actions are 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 need for corrective actions, 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.
2. The activities of the QCIC take place in three 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 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 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 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 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.
4. *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*
    - Inquire about the firm's (a) client acceptance/continuance evaluation; (b) risk assessments and audit procedures related to the areas involved in the allegations; (c) consultations outside the engagement team.
    - Discuss issues addressed by the allegations that have quality control implications with representatives of the firm.

- Discuss quality control policies and procedures and compliance therewith with firm personnel who are or have become familiar with the subject engagement.
- Inquire about or review firm technical manuals and guidance materials related to key allegation(s) and particularly evaluate changes made to the firm's quality control materials subsequent to the alleged audit failure.
- Inquire about the qualifications, training and current responsibilities of senior audit personnel assigned to the audit engagement.
- Inquire whether the firm reviewed timely other public company audits that such senior audit personnel completed within the preceding twelve months.
- Inquire about, as appropriate, inspection and peer review results of the senior audit personnel, the geographic office and the industry audit practice.
- In instances when the QCIC is uncertain about the effectiveness of the implementation of a specific area of the firm's audit manuals or guidance materials relating to the allegation(s), inspect relevant audit documentation.
- Determine if there are any lessons to be learned and communicated to the profession.

*Evaluation of Results and Appropriate Actions—*

1. Close the case file when it is concluded that:
  - Responses to QCIC inquiries provide a reasonable basis to conclude that the firm's quality control policies and procedures are adequate and, when appropriate, there has been a satisfactory evaluation of the present responsibilities of senior audit personnel pursuant to an evaluation or inspection, peer review or special evaluation of "other work."
  - Nothing more than minor changes in quality control were necessary, or the firm has taken appropriate corrective actions and has satisfied the QCIC that these changes should be effective.

5. *Corrective Actions*

- a. Corrective actions are usually undertaken voluntarily by the firm involved, either on its own initiative following consideration of the case, or at the suggestion of the QCIC team considering the matter.
- b. In some instances, corrective actions may be ordered by the QCIC, either because the firm refuses to undertake such actions voluntarily, or because the QCIC, on the basis of its evaluation of responses to 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.
- c. The scope of corrective actions is directly related to the nature of the quality control matter observed. Illustrations of corrective actions follow:
  - The firm's revision or development of policy, guidance, and/or training material related to some aspect of the quality control system. The QCIC may, if circumstance warrant, require the firm to engage outside consultants acceptable to the QCIC, to assist in the development of such materials.

- 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.
  - Review of selected engagements in the same industry—on an office or firm-wide basis—to ascertain the adequacy of industry expertise.
  - Review of an office or offices to ascertain compliance with the firm's quality control policies and procedures.
  - Review of selected engagements with similar 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.
  - Review of the entire quality control system (for example, an accelerated peer review).
- d.* In most circumstances the QCIC will close the case file when the committee and the firm reach agreement on the nature, scope and timing of the corrective action required. However, closing the case file does not alleviate the responsibility of the firm to report the progress and completion of the corrective action and for the QCIC to evaluate the satisfactory completion of the corrective action.

# 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 quality control for its accounting and auditing practice.<sup>2</sup>

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<sup>1</sup> AICPA Code of Professional Conduct, "Article VI—Scope and Nature of Services" (AICPA, *Professional Standards*, vol. 2, ET sec. 57.03)

<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.

## 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 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*

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<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.

.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.

.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.

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<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.

- 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 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

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<sup>7</sup> Regulatory agencies that have established continuing education requirements include state boards of accountancy and the U.S. General Accounting Office.



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.

## 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

<sup>8</sup> See Statement on Quality Control Standards No. 3, Monitoring a CPA Firm's Accounting and Auditing Practice.

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.

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*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

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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

---

Arleen Rodda Thomas  
*Vice President, Self  
Regulation and SECPS*

Dale R. Atherton  
*(Past) Vice President  
Peer Review*  
Kim M. Gibson  
*Technical Manager  
Audit and Attest Standards*  
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*

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 Brumeloe  
*Director, SEC Practice*

# Appendix B

## *Statement on Quality Control Standards 3, Monitoring a CPA Firm's Accounting and Auditing Practice*

Issued by the Auditing Standards Board  
May 1996

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—

- 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

<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).

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.
- 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 adequacy of and compliance with a firm's quality control system are evaluated by performing such inspection procedures as—

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<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.

<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.

- 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.

**.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.

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<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).

.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.

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*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  
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 Charles J. McElroy  
 Kurt Pany

Edward F. Rockman  
 Glenn J. Vice  
 W. Ronald Walton

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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

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Arleen Rodda Thomas  
*Vice President, Self  
 Regulation and SECPS*

Dale R. Atherton  
*(Past) Vice President  
 Peer Review*  
 Kim M. Gibson  
*Technical Manager  
 Audit and Attest Standards*  
 James V. Carey  
*Project Manager*



# Appendix C

## *Statement on Quality Control Standards 5, The Personnel Management Element of a Firm's System of Quality Control - Competencies Required by a Practitioner-in- Charge of an Attest Engagement*

Issued by the Auditing Standards Board  
January 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

**.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 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.

<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.

- 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 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.

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<sup>2</sup> Regulatory agencies that have established continuing education requirements include state boards of accountancy and the U.S. General Accounting Office.

- 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.

- 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 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*  
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 Keith O. Newton  
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 Oliver R. Whittington

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*Vice-President, Professional  
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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  
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 Charles E. Landes  
 Richard L. Miller  
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*Vice-President, Self-Regulation  
 and SECPS*

David Brumeloe  
*Director, SEC Practice Section*

Anthony J. Pugliese  
*Director, Assurance Services*



## Appendix D

# *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.

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## **Appendices**

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## 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 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.
- 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 management's 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.

## 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.
- 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, CPA—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)



## 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.
- 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.**

**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.**

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<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.

**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 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 group's 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 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 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 management's integrity.**

**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 management's 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 "opinion shopping" exists.
  - e. Evaluating the information obtained regarding management's 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.**

#### 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.
- (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 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 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 office's 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 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 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.**

**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.

## Appendices

- 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 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 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.

## 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 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.**

**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—

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<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.

- Designating a partner or a qualified individual in each office to be responsible for evaluating that practice office's 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.
- 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 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 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 management's 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 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 management's 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 “opinion shopping” exists.
- e. Evaluating the information obtained regarding management’s 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.
- 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, 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—

- 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 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—

- 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.

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.
- 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 office's 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 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 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.



## 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 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—

- 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.

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<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.

- 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.
- 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.
  - 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 management's 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.
- 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.
  - 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 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 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 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 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.**

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 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.

## 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 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.**

#### 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 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, 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.

### 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.



## 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.



