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Comparative Peer Review Cost Data

Helpful in Determining What Type of Team is Desirable

By Joseph A. DeFatta and Julian D. Smith

TABLE 1
Profile of CPA Firm Respondents (Percent Distribution)

	Number of Professionals per Firm					All Respondents
	1	2-5	6-9	10-19	20 or More	
Approximate annual accounting and auditing hours billed:						
Under 1,000	42.9	7.5	0.0	0.0	0.0	3.9
1,000 - 2,999	42.9	32.5	0.0	0.0	0.0	10.3
3,000 - 4,999	0.0	25.0	25.0	4.5	0.0	12.3
5,000 - 6,999	0.0	15.0	10.7	9.1	0.0	8.4
7,000 - 9,999	0.0	2.5	35.7	13.6	0.0	11.0
10,000 - 13,999	0.0	0.0	17.9	18.2	8.3	10.3
14,000 - 19,999	0.0	0.0	0.0	20.5	22.2	11.0
20,000 - 39,999	0.0	0.0	0.0	15.9	27.8	11.0
40,000 & over	0.0	0.0	0.0	0.0	30.6	7.1
No response	14.3	17.5	10.7	18.2	11.1	14.8
Total	100.1	100.0	100.0	100.0	100.0	100.1
Approximate annual gross billing:						
Under \$200,000	100.0	40.0	0.0	0.0	0.0	14.8
\$ 200,000 - 399,999	0.0	45.0	21.4	0.0	0.0	15.5
\$ 400,000 - 599,999	0.0	12.5	50.0	20.5	0.0	18.1
\$ 600,000 - 799,999	0.0	2.5	25.0	47.7	0.0	18.7
\$ 800,000 - 999,999	0.0	0.0	3.6	20.5	5.6	7.7
\$1,000,000 - 1,199,999	0.0	0.0	0.0	6.8	16.7	5.8
\$1,200,000 - 1,399,999	0.0	0.0	0.0	4.5	11.1	3.9
\$1,400,000 - 1,599,999	0.0	0.0	0.0	0.0	11.1	2.6
\$1,600,000 & over	0.0	0.0	0.0	0.0	52.8	12.3
No response	0.0	0.0	0.0	0.0	2.8	.6
Total	100.0	100.0	100.0	100.0	100.1	100.0

The division for CPA firms of the American Institute of Certified Public Accountants (AICPA) has been operational for over three years. The division was created primarily to improve the profession's ability to regulate itself. The basic means of regulation is the peer review which must be undertaken once every three years. By reviewing the quality control policies and procedures of each member firm through peer review, the division is striving to enhance the image of the profession and to improve the quality of services rendered.

The division has periodically published statistics regarding the cost of peer reviews for member firms of the Private Companies Practice Section (PCPS) in its *PCPS Reporter*. These statistics, however, relate only to those firms which have had reviews conducted by committee appointed review teams (CART). In addition to CART, reviews are performed by three other types of review teams: firm on firm, association, and society.

This study was undertaken to provide comparative data for reviews conducted by all types of teams. These statistics should provide useful information to firms that are considering a change in the type of team for their next peer review. The data should also be informative for those firms that are considering joining the division. In order to facilitate comparisons, all statistics are classified by firm size (as measured by the number of professionals).

The Study

Data for this study were gathered through a questionnaire mailed to 300 members of the division. The recipients of the questionnaire were selected randomly from a list of approximately 500 PCPS members that had been reviewed as of January 31, 1982.

A total of 155 usable questionnaires were returned for a response rate of 51.7% as shown.¹ The response percentages in each size category closely paralleled the composition of membership in the PCPS, as reported in the April 1982 *PCPS Reporter*.

Summary of Mail Survey

Number Professionals	Number of Firms Responding	Percent
One	7	4.5
Two - five	40	25.8
Six - nine	28	18.1
Ten - nineteen	44	28.4
Twenty or more	36	23.2
Total	155	100.0
Approximate number of firms with completed peer reviews as of January 31, 1982	500	
Questionnaires mailed	300	
Overall response rate		51.7%

TABLE 2
Type of Peer Review Team (Percent Distribution)

Type of Review Team	Number of Professionals per Firm					All Respondents
	1	2-5	6-9	10-19	20 or more	
Firm on firm	14.3	15.0	21.4	13.6	22.2	17.4
CART	57.1	80.0	71.4	59.1	36.1	61.3
Association	14.3	2.5	7.1	25.0	41.7	19.4
State society	14.3	2.5	0.0	2.3	0.0	1.9
Total	100.0	100.0	99.9	100.0	100.0	100.0

Table 1 provides information regarding annual accounting and auditing (A & A) hours for responding firms as well as annual gross billing data. These statistics are provided to permit firms to compare their practices with those of their peers.

The types of review teams selected by the responding firms to perform their peer reviews are reported in Table 2. For those firms in the size categories ranging from 1 to 19 professionals, CART was the most widely used review team. On the other hand, the largest firms (20 or more professionals) utilized an association review team most frequently. In general, the table reveals that as the size of the firm increases the type of team selected becomes more evenly distributed among the three most popular teams. The small number of firms (three) employing a state society team appears to indicate that most state societies have not yet provided a review team mechanism for their members.

Table 3 is a summary of peer review costs by firm size and type of review team. Peer review costs include all out-of-pocket expenditures such as reviewers' time charges, travel and lodging, and the AICPA's administrative fee where applicable. These review costs are incurred once every three years. As would be expected, the average peer review cost per professional for all respondents tends to decrease as the firm size increases, reflecting economies of scale. For example, the average cost for a

TABLE 3
Summary of Peer Review Costs

Type of Review Team	Number of Professionals per Firm				
	1	2-5	6-9	10-19	20 or more
Firm on firm					
Number of firms	1	6	6	6	8
Low	\$ 775	\$ 700	\$2,375	\$1,800	\$ 4,450
Average	\$ 775	\$2,264	\$3,229	\$3,333	\$ 7,044
High	\$ 775	\$4,000	\$4,500	\$4,500	\$10,000
Average cost per professional	\$ 775	\$ 566	\$ 388	\$ 233	\$ 235
CART					
Number of firms	4	32	17	25	13
Low	\$1,699	\$1,100	\$1,500	\$2,100	\$ 3,900
Average	\$1,874	\$2,190	\$2,776	\$4,192	\$ 7,568
High	\$2,000	\$4,000	\$4,400	\$7,000	\$15,000
Average cost per professional	\$1,874	\$ 535	\$ 372	\$ 310	\$ 211
Association					
Number of firms	1	1	2	10	15
Low	\$ 997	\$1,100	\$3,600	\$2,500	\$ 3,500
Average	\$ 997	\$1,100	\$4,113	\$4,932	\$ 6,108
High	\$ 997	\$1,100	\$4,625	\$7,826	\$10,075
Average cost per professional	\$ 997	\$ 220	\$ 457	\$ 355	\$ 221
Society					
Number of firms	1	1	0	1*	0
Low	\$ 625	\$1,500	—	\$ 675	—
Average	\$ 625	\$1,500	—	\$ 675	—
High	\$ 625	\$1,500	—	\$ 675	—
Average cost per professional	\$ 625	\$ 500	—	\$ 61	—
All respondents					
Number of firms	7	40	25	42	36
Low	\$ 625	\$ 700	\$1,500	\$ 675	\$ 3,500
Average	\$1,413	\$2,156	\$2,991	\$ 4,162	\$ 6,843
High	\$2,000	\$4,000	\$4,625	\$ 7,826	\$15,000
Average cost per professional	\$1,413	\$ 529	\$ 384	\$ 305	\$ 220

Excludes five unusable responses

*Included as a valid response although the cost appears unrealistic

sole practitioner (no professional staff) is \$1,413 compared to a cost of \$220 for firms with 20 or more professionals.

An analysis of the data by firm size reveals that a peer review performed by a CART team for a sole practitioner resulted in the highest average cost per professional (\$1,874). In contrast, a review administered by a society-appointed team produced the lowest average cost (\$625) for a sole practitioner.²

For those firms with two to five professionals and six to nine professionals, there is no significant difference in the average cost of peer reviews performed by firm-on-firm or CART review teams in the respective size categories. In firms with ten to nineteen professionals, however, the average cost of a review by a firm-on-firm team is substantially lower than the cost of a CART or association review. On the other hand, the average review cost for the largest firms (20 or more professionals) is approximately the same for each type of review team.

Peer review costs as a percentage of annual revenue by firm size and type of review team are presented in Table 4. Practitioners may find this information useful in budgeting and comparing their review costs with other firms. Average review costs for all types of teams ranged from 1.6% of annual gross billings for sole practitioners to .4% for the largest firms. With some exceptions, the CART review resulted in the lowest peer review costs as a percentage of revenue.

Table 5 summarizes peer review costs per accounting and auditing hour by firm size and type of review team. As previously discussed, economies of scale are also evident in this analysis. Thus, average review cost per A&A hour ranges from \$1.12 for sole proprietors to \$.24 for the largest firms. Although no definite trend is discernible, an analysis by firm size indicates that cost per A & A hour tends to become less variable for all types of teams as the size of the firm increases.

Summary

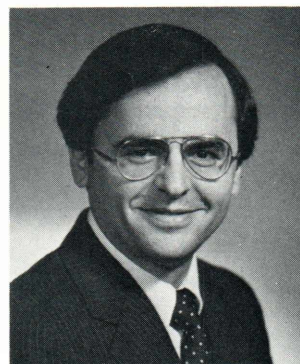
The small number of survey responses in certain categories limits to some extent the generalizations that can be derived from the data. For example, only three of the responding firms utilized a state society review

TABLE 4
Average Peer Review Cost Per Dollar of Revenue

Type of Review Team	Number of Professionals per Firm				
	1	2-5	6-9	10-19	20 or more
Firm on firm					
Number of firms	1	6	6	6	8
Average revenue (gross billings)	\$ 38,000	\$215,583	\$546,667	\$711,667	\$1,524,375
Average peer review cost per dollar of revenue	2.0%	1.1%	.6%	.5%	.5%
CART					
Number of firms	4	32	17	25	12
Average revenue (gross billings)	\$123,250	\$249,734	\$474,235	\$724,320	\$1,945,833
Average peer review cost per dollar of revenue	1.5%	.9%	.6%	.6%	.4%
Association					
Number of firms	1	1	2	10	15
Average revenue (gross billings)	\$ 55,000	\$175,000	\$513,905	\$787,800	\$1,679,733
Average peer review cost per dollar of revenue	1.8%	.6%	.9%	.6%	.4%
Society					
Number of firms	1	1	0	1*	0
Average revenue (gross billings)	\$ 24,000	\$165,000	—	\$680,000	—
Average peer review cost per dollar of revenue	2.6%	.9%	—	.1%	—
All respondents					
Number of firms	7	40	25	42	35
Average revenue (gross billings)	\$ 87,143	\$240,625	\$494,792	\$736,571	\$1,735,457
Average peer review cost per dollar of revenue	1.6%	.9%	.6%	.6%	.4%

Excludes six unusable responses

*Included as a valid response although the peer review cost appears unrealistic



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TABLE 5

Average Peer Review Cost Per Accounting and Auditing Hours

Type of Review Team	Number of Professionals per Firm				
	1	2-5	6-9	10-19	20 or more
Firm on firm					
Number of firms	1	6	6	4	7
Average annual accounting and auditing hours	1,000	2,641	7,558	12,135	33,993
Average peer review cost per A and A hour	\$0.78	\$0.86	\$0.43	\$0.27	\$0.20
CART					
Number of firms	3	25	16	22	12
Average annual accounting and auditing hours	1,507	3,655	6,788	12,320	30,317
Average peer review cost per A and A hour	\$1.22	\$0.62	\$0.40	\$0.35	\$0.25
Association					
Number of firms	1	1	1	7	14
Average annual accounting and auditing hours	550	500	10,683	12,485	24,203
Average peer review cost per A and A hour	\$1.81	\$2.20	\$0.43	\$0.45	\$0.25
Society					
Number of firms	1	1	0	1*	0
Average annual accounting and auditing hours	1,000	2,250	—	16,700	—
Average peer review cost per A and A hour	\$0.63	\$0.67	—	\$0.04	—
All respondents					
Number of firms	6	33	23	34	33
Average annual accounting and auditing hours	1,178	3,332	7,158	12,461	28,503
Average peer review cost per A and A hour	\$1.12	\$0.66	\$0.41	\$0.35	\$0.24

Excludes 26 unusable responses

*Included as a valid response although the peer review cost appears unrealistic.

team. With this limitation in mind, it would appear that smaller firms should carefully consider the alternative types of teams available since the cost of their peer review is subject to greater variability than for the larger firms.

For larger firms the cost of the peer review may be a less critical factor in selecting a review team since there is less variation in cost for these firms. Possibly larger firms should place more emphasis on such factors as: (1)

experience of the team in conducting peer review, (2) familiarity of the team with industries in which the firm's clients operate, (3) ability to schedule a team at an appropriate time, and (4) reputation of the team for conducting reviews in an efficient manner for providing constructive recommendations regarding changes in firm policies and procedures. Of course, these intangible factors may also be of greater importance than cost for smaller firms.

This study has given some insights as to the cost of peer reviews conducted by firm-on-firm, CART, association, and society teams. The data will enable practitioners to compare their peer review cost with other firms and help them to determine if a change in the type of team is desirable. Ω

NOTES

¹Although many firms are members of both the PCPS and the SEC Practice Section (SECPS), only one of the 155 respondents indicated that it had undergone a SECPS peer review. Thus this study is essentially an analysis of the costs of PCPS peer reviews.

²Some of the statistics in the study are based on one or two responses and should be given appropriate consideration when comparisons are made to other statistics based on a larger number of responses.

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