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THE INSTITUTE'S LOCAL FIRM QUALITY REVIEW PROGRAM

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The Institute's local firm quality review program

by William C. Bruschi, AICPA vice president—administrative services

Managing partners of firms reviewed under the Institute's local firm quality review program are enthusiastic about its benefits. They believe that the reviews result in reasonable recommendations for improving the quality of their firms' work and in practical suggestions for upgrading the effectiveness of their procedures (see comments on page 109).

The program enables CPA firms, on a voluntary basis, to have independent in-house reviews of their workpapers and reports. Educational features incorporated in the program make it possible for CPAs to profit from methods followed by their peers—the reviewers—and thus to improve the quality of their audit procedures, workpapers and reports.

The quality review program came into being in early 1971 upon the recommendation of the Institute's planning committee. The next two years—1971 and 1972—were given over to developing the techniques of the program and testing them in pilot reviews. These years were also needed to train reviewers so that the review program could be offered nationally.

In 1973, the program became operational when 58 reviews were conducted in 28 states. Since the reviewers also learn from the reviews, another 43 firms, located in 27 states, that provided reviewers also gained from the program. Eliminating duplications, the benefits of the program were spread over 101 CPA firms in 39 states.

The objectives of the program can be summarized as follows:

1 To review the overall audit practice of a CPA firm or an office of the

firm and to make suggestions for improvement where appropriate.

2 To review completed individual audit and unaudited statement engagements for

a Technical competence displayed in the engagement as evidenced by supporting workpapers and documentation.

b Fairness of presentation of financial statements in conformity with generally accepted accounting principles.

c Reasonableness of the accountant's opinion expressed on the financial statements.

Why the program was started

In recommending the quality review program, the planning committee was mindful of the fact that the quality of the audit depends upon the competence of the practice unit. But if the quality of the audits by too many of the practice units does not meet public expectations, the profession as a whole would suffer. Consequently, the profession as a whole has a legitimate interest in the nature and behavior of all practice units.

The planning committee recognized that many CPA firms maintain various quality review mechanisms—including research departments, report-review departments, field inspections, information retrieval facilities—and have available specialists for consultation at all times. But for those practice units which do not maintain such quality review mechanisms, the Institute must provide a quality review service on a fee basis.

A quality review service meets the needs of CPA firms that want to know if their audit and unaudited

statements engagements are being conducted in accordance with customary practice of the profession. These firms realize that their growth is dependent upon their providing satisfactory professional services to clients and to third-party readers of financial statements.

On the other hand, many firms may be unaware of deficiencies in their practices. For them, their survival as a firm could well be at stake.

Finally, the program is a means for impressing upon the public the fact that CPAs are determined to render service of distinguished quality. It is reassuring to users of accounting services to know of this voluntary program for maintenance of professional competence.

Benefits of a quality review

As a result of undergoing a quality review, a CPA firm has the benefit of independent constructive criticism of its procedures and reporting policies. A "fresh view" of those procedures and policies often results in suggestions as to how techniques can be improved—for example, through greater use of statistical sampling.

Frequently the managing partner uses a quality review as a point of departure for improving his firm's practice. The reviewers serve as "experts" and their opinions are used to spark programs to improve the overall quality and efficiency of the firm.

Sometimes the findings of the reviewers confirm weaknesses which the managing partner sensed but which had not been pinpointed by him. In other instances, he may learn of unsuspected deficiencies.

Deficiencies can be traced by the firm, at its option, to the responsible personnel. These individuals, then, can be directed to continuing education courses or other educational means to raise their competence.

A side benefit is obtained from the exchange of ideas with other practitioners regarding the procedures and policies which have assisted them in improving their practices. These exchanges range over many aspects of practice and often result in suggestions that can be implemented easily and are cost-saving.

In fulfilling its commitment to provide a qualified reviewer for a subsequent quality review, the firm obtains substantial benefits from his or her experience in reviewing another firm's procedures and policies. Fre-

quently reviewers identify techniques which will help their own practices. Indeed, such benefits to reviewers often result in their volunteering for two, three or more reviews each year. In a sense, this is a case of the teacher learning from the pupil.

Confidential nature of reviews

Reviews are conducted on a confidential basis. No written reports are prepared. Only verbal reports are made to managing partners.

Reviewed firms are also required not to disclose the fact that they underwent quality reviews. The Institute issues no publicity and gives no public recognition to a firm's participation in the program. Nor is the Institute permitted to respond to inquiries as to whether or not a practice unit participated in the program.

This prohibition of publicity prevents impressions that firms have met prescribed standards and thereby are "approved" or "accredited." The program is intended to provide firms with an opportunity to improve their work and not to serve as a means of distinguishing them from others.

What happens during a review

While a quality review is scheduled as a two-day engagement for two reviewers, that is, four man-days, usually the managing partner and reviewers have dinner together the evening before the review begins. This enables them to become acquainted and to discuss how the review is to be conducted. Sometimes they also dine together at the end of the first review day so that they can talk about the progress being made.

During the review, the reviewers examine workpapers and reports for engagements selected by the reviewed firm. These engagements should be representative of the firm's practice, although engagements may also be selected because they fall into industry classifications for which the firm is seeking guidance.

Two checklists—a 47-page list for audit engagements and a 6-page list for unaudited statement engagements—are used by the reviewers to focus on the procedures used by the firm. These checklists pose questions in connection with the review of the accountant's report, the financial statements and notes, permanent file and current workpapers for typical accounts such as cash, receivables, investments, inventories, payables, de-

ferred credits, capital, income, expense, etc. Checklist sections also deal with the form and content of the workpapers, review procedures, audit planning and administration.

As appropriate, the questions are referenced to paragraphs of Accounting Principles Board Opinions, accounting research bulletins and Statements on Auditing Standards. Checklists are updated periodically to provide references to newly issued authoritative pronouncements.

Firms wishing to conduct an internal review of their procedures may purchase blank checklists from the Institute for \$20 a set—a checklist for an audit engagement and one for an unaudited statements engagement. If the purchaser decides subsequently to arrange for a quality review, the \$20 is applied to the fee for the review.

A typical quality review usually covers four audit engagements and three unaudited statements engagements. The number of engagements reviewed, of course, is dependent upon their size.

Reviewers point out that it is seldom necessary to look over more than three or four engagements, because the firm's typical procedures become evident in a small number of engagements.

During the course of the review, the reviewers complete the checklists and make additional notes of matters to be discussed in their report. The intent is to focus on salient points and not to engage in nit-picking. Since the reviewers are experienced in office procedures, they endeavor to go about their task with the least possible disruption of the office.

In the afternoon of the second day, the reviewers meet with the managing partner and others to present their oral report. The reviewers endeavor to make constructive and reasonable comments about the firm's procedures. The quality review program is educational in nature, and the reviewers' report is made in keeping with this purpose.

Personal qualifications of reviewers

The basic personal qualification of reviewers is that they be competent auditors. They are audit partners or, in some instances, audit staff members responsible for the review of workpapers. Exceptions are made for those who conduct quality reviews within their firms, as noted

below. Of course, reviewers are certified public accountants.

This emphasis on auditing expertise and currentness of that expertise ties in with the review procedures which are focused on the firms' auditing procedures evinced in workpapers and on the accountants' reports issued for the engagements. The reviewers must be qualified to relate workpaper audit evidence to the resultant accountants' reports.

As all auditors know, audit procedures, financial statement disclosures and accountants' reports are affected by current professional and income tax pronouncements. Reviewers, therefore, are required to have knowledge of APB Opinions and interpretations, Statements on Auditing Standards and other authoritative accounting literature such as Institute audit and accounting guides and income tax promulgations. Such knowledge must be current so that it can be applied realistically to the engagements being reviewed.

Potential reviewers are screened initially during the reviews of their firms. Lead reviewers judge the professional competence of those dealt with in the course of the reviews. Therefore, before individuals are designated as assistant reviewers for their first reviews, the evaluations of the lead reviewers, who observed them at their firms' offices, are obtained and considered.

Subsequently, the performances of the individuals as assistant reviewers are evaluated by the lead reviewers. Judgments are made about their competence both as assistant reviewers and as potential lead reviewers. These judgments relate to their technical knowledge, thoroughness, alacrity and personal commitment to the quality review program.

On the other hand, judgments concerning the competence of those serving as quality reviewers for their firms are based on the experience of the individuals and the recommendations of their firms. They are also interviewed before receiving their initial Institute review assignments.

The Institute maintains records of the qualifications of reviewers and potential reviewers. These records are consulted in scheduling reviews to determine that the best available reviewers are assigned to an engagement.

At this time, the bank of qualified

reviewers numbers some 230 CPAs who are scattered throughout the United States. This large bank means that requests for reviews can be filled promptly almost anywhere in the country.

Members of the local firm quality review committee, which directs the program, form the nucleus of the bank of reviewers, for they are expected to conduct at least one review a year. This ongoing participation is a means for them to check on the adequacy of the program and its acceptance.

A substantial proportion of the reviewers is drawn from firms which have been reviewed. Most are experienced in conducting reviews and continue to serve because of the personal educational benefits they derive from examining other firms' procedures and policies and because of the personal satisfaction they obtain from contributing to the maintenance of professional standards. Many participate in two or three reviews each year. Others are fulfilling their firms' commitments to provide assistant reviewers in connection with the review engagements; their qualifications are checked, of course, before they receive assignments.

An important source for reviewers is the national accounting firms that have volunteered the services of their partners and senior staff members who review their firms' practice of-

ces. Some are assigned review responsibilities on a full-time basis by their firms and others balance review responsibilities with audit engagement responsibilities. They are skilled in the audit procedures of their firms and meld this expertise with the techniques of the Institute's program.

How reviewers are assigned

Matching reviewers with firms to be reviewed is done with care. Many factors are considered in making the initial match-ups of reviewers and reviewed firm. Sometimes subsequent match-ups for the same engagement are necessary, because professional or personal responsibilities cause reviewers to withdraw after accepting assignments.

Setting the dates for the review is the first task. Since the firm's managing partner and audit partner must be on hand for the reviewers' oral report, their availability is a prime consideration. It is not necessary, however, for them to be present when the reviewers are inspecting workpapers and reports.

The availability of the reviewers is of equal importance. In addition to the two full days to be spent in the firm's offices, reviewers must make allowances for travel time. Often reviewers plan to arrive in the early evening of the day before the review and meet with the managing partner

Comments from reviewed firms

"In general, we are very well satisfied with the Institute's quality review program and consider that it is well worth the cost. . . . The advantage to a local firm of such a program is that a competent, objective critique is applied to its work. Ordinarily a local firm is not in a position to establish a review team that is completely independent of other functions and loyalties.

"We were reassured to find that we were, in the main, doing a good job of auditing and statement presentation. However, it was also . . . pointed out to us that our workpapers are less than complete and do not fully protect our position if we are called upon to defend or explain them."

". . . as a result of this experi-

ence, we want to have another review to . . . check on how well we have absorbed the results of this one. We would not hesitate to recommend this program to any other accountants as a very worthwhile program."

"The two reviewers were well prepared and well qualified to conduct the review, and we feel they covered considerable territory. . . . They were completely objective, and we had an excellent frank discussion of their findings at the end of the second day.

"As a result of the review, we anticipate correcting what weaknesses were pointed out, continuing the policies and practices in which we show strength and generally upgrading the quality of our work."

to plan the engagement. Sometimes the reviewers' departures are delayed. For example, on two occasions in Rocky Mountain states, reviewers were snowbound for two days by unexpected storms after the engagements.

Knowledge of industries or types of clients which form the bulk of the firm's practice is considered in assigning reviewers. A firm with a concentration of clients in the retail or utility fields might ask for reviewers with such expertise. On the other hand, the firm may be anticipating expansion of a segment of its practice—for example, audits of local governmental units as required by a new state statute—and, as a consequence, request reviewers experienced in such audits.

Reviewers are intentionally assigned from states other than the one in which the firm is located. To illustrate, an Indianapolis firm could be reviewed by CPAs from Buffalo, or Pittsburgh, or Memphis, or St. Louis. Out-of-state reviewers are assigned to avoid competitive advantages which might possibly develop from looking over engagement papers. Also to be avoided are subsequent social contacts which might be uncomfortable.

In scheduling reviews, firms to be reviewed are told in advance the names of the reviewers and their firm affiliations. Should the firm prefer others, changes can be made. It is also possible to seek a reviewer from a particular firm if such a preference is expressed.

How to arrange for a quality review

The decision to undergo a quality review is entirely voluntary. The program is educational in nature and purpose and not censorious or accreditation. Hence a firm seeking to improve its technical competence through the educational benefits of a quality review must initiate a request for a review.

The request should be placed with the Institute staff member administering the program, Albert H. Zitzmann, manager, quality review.

In response to the request, a letter setting forth the terms and conditions of the engagement is sent to the firm. The letter includes the condition that the firm will not disclose the identity of the reviewers or their comments or the fact of a quality review to any person outside the firm other than

practicing CPAs, their professional associations and state boards of accountancy.

The letter asks for such background material on the firm as the nature of its practice and biographical data of the professional personnel. This information is needed to select reviewers who have knowledge of the firm's special areas of practice. An awareness of the backgrounds of the firm's professional personnel is helpful to the reviewers who will be dealing with them and their work.

The engagement letter sets forth the financial arrangements for the review and urges that a commitment be made to provide a qualified person to serve as an assistant reviewer for the review of another CPA firm.

Conclusion

In view of the enthusiastic reception of the program, it is estimated that more than 150 reviews will be conducted in 1974. This estimate represents a threefold increase over 1973. Yet this anticipated participation would be only a minuscule portion of the total number of CPA firms.

The local firm quality review committee nurtured its program with care in its formative years. Since no other profession had successfully established a comparable voluntary program, the committee wanted to be certain that the needs of Institute members were being served to their satisfaction before the program was widely publicized.

The committee is now studying ways of broadening participation. The nagging fear exists, however, that some managing partners may not realize that their firms urgently need quality reviews. Increased publicity for the program will increase participation, hopefully by those firms who might gain the most from a quality review.

The CPE schedule for April

Following is a list of the continuing professional education courses that are slated for presentation next month. The schedule includes all AICPA-sponsored programs and all known CPE offerings sponsored by state CPA societies.

Readers interested in attending any of the programs are advised to register immediately with the CPA society of the state in which the program is being held. Registration is

open to all CPAs and to others desiring continuing education in the topics offered. Additional information about each course is available from the sponsoring state society.