

**Report of the
Peer Review Process Task Force
Executive Committee
SEC Practice Section of the AICPA
January 25, 2000**

Purpose

The Peer Review Process Task Force (Task Force) was formed by the Executive Committee of the SEC Practice Section of the American Institute of CPAs (SECPS) in March 1999 for the purpose of determining ways of improving the effectiveness of peer reviews conducted under the SECPS peer review program. The formation of the Task Force and the need to reexamine the peer review program was encouraged by the SECPS Peer Review Committee (PRC), the Public Oversight Board (POB), and the staff of the Securities and Exchange Commission (SEC). These groups seek:

- enhancements in the reporting of the results of peer reviews;
- improvements in the effectiveness of peer reviews, for example by emphasizing the timely identification and testing of emerging issues and higher-risk areas during peer reviews;
- comprehensive governance and oversight of the peer review process; and
- peer reviews performed by appropriately qualified and trained reviewers.

Task Force Deliberations

A list of the Task Force members is attached. The members have the following affiliations:

- SECPS Executive Committee
- SECPS Peer Review Committee
- SECPS SEC Regulations Committee
- AICPA Peer Review Board
- AICPA Auditing Standards Board
- Nasdaq

Also participating in the deliberations of the Task Force was a member of the POB, staff of the POB, and staff of the POB's Panel on Audit Effectiveness. Additionally, members of the Task Force met individually with several groups who are users of peer review reports, but were not directly represented in the deliberations of the Task Force, to obtain feedback from them regarding the peer review program. These meetings included representatives from the SECPS Quality Control Inquiry Committee, the U.S. Department of Labor, several State boards of accountancy, and several State CPA societies who administer the AICPA's Peer Review Program applicable to non-SECPS member firms.

Background and Objectives of the SECPS Peer Review Program

The origins of the profession's programs for voluntary self-regulation date back to 1977. Since then these programs have been continuously reviewed and enhanced with the changing practice environment and market conditions. Currently, SECPS member firms must have their quality control systems reviewed by independent peers once every three years. These reviews are system and compliance oriented with the objectives of evaluating whether:

- 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.
- The reviewed firm's quality control policies and procedures were being complied with to provide the firm with reasonable assurance of conforming with professional standards.
- The reviewed firm was complying with the membership requirements of the SECPS in all material respects.

In a peer review, an independent team of CPAs, typically a firm-on-firm review, reviews the firm's stated quality control policies and procedures to determine whether they meet the elements of quality control set forth in professional standards. Then the review team tests whether the firm's personnel have consistently applied these policies and procedures by looking at specific engagements and compliance with firm-wide quality control systems, for example systems pertaining to independence, client acceptance, and professional development. The review team's conclusions are documented in a written report—which may be unmodified, modified or adverse—and, when appropriate, a letter of comments addressing matters that require action by the reviewed firm. The reviewed firm then responds to the letter of comments in writing, stating what corrective actions it intends to take.

The PRC establishes and maintains review standards. At regular meetings and through report evaluation task forces, the PRC considers each peer review, evaluates the reviewer's competence and performance, and examines every report, letter of comments, and accompanying response from the reviewed firm that states its corrective action plan before it is finalized. In its deliberations, the PRC may also question the peer review team or require the team to revisit the reviewed firm to perform additional procedures. The POB staff plays a key role in overseeing the performance of peer reviews working

closely with peer review teams and the PRC. The working papers prepared on all peer reviews performed under the SECPS program are reviewed by the SECPS staff or POB staff.

Based on the nature of the peer review results, the PRC may require remedial measures beyond those contemplated in the reviewed firm's letter of response and require active monitoring of the firm's follow-up to assure that corrections are made. On some occasions, the PRC requires an accelerated follow-up peer review.

Once the PRC accepts them, peer review reports, letters of comments, and reviewed firms' responses are maintained in a file available to the public.

The SEC also oversees the SECPS peer review program and makes its own evaluation of the adequacy of the program and the POB's oversight of it. After the PRC accepts reports on the peer reviews of member firms with one or more SEC clients, the POB arranges with the SEC staff to review the POB's oversight files and the peer reviewer's working papers for a sample of the reviews based on the SEC access to working papers protocol set forth in the peer review standards. The SEC reports on its evaluation of the peer review program in its annual report to Congress.

Comments and Recommendations

After evaluating the current peer review program and obtaining feedback from various user groups, the Task Force reaffirmed the previously stated objectives of the peer review program. The structure for administering, conducting, and overseeing peer reviews should continue to strive for improvements in the performance of member firms' accounting and auditing practices and provide a means for fostering remedial actions when necessary. The Task Force also concluded that it is in the public's, and the profession's, interest to continue to have peer reviewers express opinions on the design of quality control systems and a firm's compliance with those quality control systems.

However, the Task Force identified four areas of the current peer review program that it believes should be improved. The four areas are: Reporting, Process, Governance and Oversight, and Qualifications and Training of Reviewers. The Task Force believes improvements in these areas will enhance the effectiveness of future peer reviews.

Reporting

Overview

Currently, individuals can request (either orally or in writing) the contents of the SECPS's public file which includes a member firm's three most recent annual reports, their most recent peer review report and, if applicable, the letter of comments and letter of response issued pursuant to their most recent peer review report, and the PRC's acceptance letter of such peer review. In addition, any actions required to be taken by the reviewed firm as a condition of acceptance of its peer review report are included in the firm's acceptance letter. Peer review reports and letters of comments are prepared based on the Standards for Performing and Reporting on Peer Reviews established by the PRC. Other communications regarding the results of peer reviews that are not available to the public are made orally

at exit conferences with firm management and in Summary Review Memoranda¹ presented to the PRC² (and available to the POB and SEC).

The Task Force believes that in order to best serve the public interest, the future peer review reporting model must be more transparent and better facilitate the communication of matters identified during peer reviews that should be addressed by reviewed firms and the profession. More transparent reporting would inform users of peer review reports and letters of comments about the conduct of peer reviews and expand the disclosure about the findings pertaining to the reviewed firms' quality control systems and compliance with those systems. The reporting model also should provide for the communication of best practices, constructive suggestions that go beyond professional standards, and matters for the attention of standards setters. To accomplish this, peer reviewers and reviewed firms should consider the PRC as the "audit committee" so that they have appropriate information to perform their functions effectively. Additionally, the future reporting model should provide appropriate access to information for the SEC staff to assess the effectiveness of the peer review program.

Recommendations

1. The SECPS should:
 - a. Continue to maintain a file that provides for public access to peer review reports, letters of comments, and the firms' responses to the letters of comments. We understand the SECPS is in the process of developing a system for including the documents contained in the public file on the Internet. The Task Force supports efforts to make the public file more accessible.
 - b. Study whether there are key quantitative and qualitative performance indicators that would be useful to users of SECPS member firms' annual reports or peer review reports. Such information might include, for example, the number of audits performed during the year compared to key qualitative indicators that are relevant, objective, and measurable.
2. The PRC should make changes to the Standards for Performing and Reporting on Peer Reviews for the following:
 - a. Revise the standard peer review report to more fully describe the peer review process and matters relevant to the specific peer review.

¹ The Standards for Performing and Reporting on Peer Reviews require that a Summary Review Memorandum be prepared on each peer review. The memorandum describes the planning of the review, the scope of the work performed, the findings and conclusions supporting the report and letter of comments issued, and the comments communicated to firm management during the exit conference that were not deemed of sufficient significance to include in the letter of comments.

² The Summary Review Memorandum is presented to the PRC for firms with 30 or more SEC clients or in instances where it is necessary for consideration by the PRC in accepting the applicable peer review report.

- b. Peer review reports should be addressed to the reviewed firm and the PRC to emphasize that peer reviewers and reviewed firms should consider the PRC as the “audit committee.”
- c. Require a Summary Observations Memorandum be prepared on all peer reviews that describes the peer reviewer’s observations regarding best practices, constructive suggestions that go beyond professional standards, and matters for the attention of standards setters. The Summary Observations Memorandum should be submitted to the PRC along with the other documents that are required to be submitted (all of which are available to the POB). To encourage candid communications, the Summary Observations Memoranda prepared on peer reviews each year should not be made available for public distribution, but should be used as a basis for preparing the PRC annual report described in Recommendation 4 c. The SEC staff should have access to the PRC annual report and, in its oversight role, should have access to the Summary Observations Memoranda on a no-name basis.

Process

Overview

As previously indicated, the PRC establishes and maintains the Standards for Performing and Reporting on Peer Reviews. Although there are approximately 1,300 SECPS member firms of various sizes and types of practices, the peer review standards are common to all member firms and do not provide for these differences. The Task Force believes the peer review process needs to recognize that not all firms are the same and adapt the peer review procedures accordingly. The peer reviews of larger, more complex firms with extensive quality control systems and internal inspection programs³ should have more frequent peer review involvement and eliminate redundancies with internal inspection programs. Further, the Task Force believes the peer review process needs to place greater emphasis on ascertaining auditor performance versus evaluating documentation to determine compliance with quality control systems and professional standards.

Recommendations

3. The PRC should make changes to the Standards for Performing and Reporting on Peer Reviews for the following:
 - a. There should be a prescribed differentiation of the SECPS member firms, based on the effectiveness and objectivity of the firms’ internal inspection programs. Tier A firms should be those that do not have an internal inspection program that meets specifically defined

³ The larger, more complex firms have established extensive internal inspection programs. These programs are designed to annually 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 its personnel’s compliance with them. The inspection procedures performed are similar to those performed during tri-annual peer reviews. Such procedures place significant emphasis on reviewing engagements performed by a cross section of the firm’s accounting and auditing personnel.

criteria for a Tier B firm. Tier B firms should be those firms that have an effective internal inspection program that meets specifically defined criteria. The effectiveness of a reviewed firm's internal inspection program should be determined by the peer reviewer. The PRC, with the POB's oversight, should concur with the classification of firms.

- b. The peer reviews of Tier A firms should be systems and compliance oriented but place greater emphasis on the reviews of engagements, while the peer reviews of Tier B firms should involve reviews of engagements but place greater emphasis on systems and compliance.
- c. Tier B firms should be required to engage their peer reviewers to annually perform certain limited review procedures, in addition to the peer review performed on a tri-annual basis. The procedures performed by the peer reviewer on an annual basis should include: (1) follow-up on actions taken by the reviewed firm in response to the letter of comments, if any, and Summary Observations Memorandum from the most recent peer review, the Recommendations Letter (described below), if any, from the most recent annual limited procedures engagement, and the findings of the prior year internal inspection program; (2) review the design of any significant changes in the reviewed firm's system of quality control for its accounting and auditing practice; (3) review changes to the firm's policies and procedures designed to implement significant new professional standards; (4) review the plan for and results of the reviewed firm's internal inspection program, including determining whether it included consideration of emerging issues and higher-risk areas, and determine whether the reviewed firm has taken appropriate actions with respect to any engagements with material findings noted in the inspection program; and (5) if considered appropriate, prepare a Recommendations Letter communicating to the reviewed firm any observations and recommendations resulting from the limited procedures engagement. The Recommendations Letter would be sent to the PRC for informational purposes. However, if the peer reviewer determines that the firm has not taken appropriate actions with respect to material findings, the peer reviewer should refer such circumstances to the PRC for further consideration. Additionally, the POB should conduct oversight of the annual limited procedures engagement.
- d. The tri-annual peer review for Tier B firms should be integrated with the reviewed firm's internal inspection program in that year and focus on emerging issues and higher-risk areas, while relying on the internal inspection program (with some testing by the peer reviewer) to review routine and compliance areas. The reviewed firm's internal inspection program should become an integral part of the peer review in that the peer reviewer should review and approve inspection review procedures, review materials and questionnaires, and office and engagement selections made for the inspection program, and form joint teams of internal inspectors and peer reviewers for certain reviewed offices. The objectives of this more integrated involvement are to provide the peer reviewer with more direct, ongoing knowledge of the effectiveness of the firm's quality control systems and inspection program. Also, if the internal inspection program is determined to be effective, this approach allows

the peer reviewer to perform less routine and compliance review procedures and focus primary attention on the areas of higher-risk and emerging issues. For example, in some instances, peer reviewers might review on a surprise basis only those portions of engagements pertaining to emerging issues and higher-risk areas.

- e. The review materials and questionnaires should be revised to generate more qualitative, subjective, and judgmental considerations and findings by peer reviewers. The qualitative considerations by the peer reviewer should include in-depth interviews of the engagement team at all experience levels with respect to the approach taken in areas of higher-risk and emerging issues to provide a basis for judgmentally evaluating whether the engagement team possessed the necessary experience and appropriate information to adequately and timely plan and perform the audit procedures. Peer reviewers also should conduct focus group sessions with professional personnel at various levels in the organization in order to obtain candid feedback regarding critical matters pertaining to the accounting and auditing practice. The qualitative, subjective, and judgmental findings from these procedures should result in observations and recommendations regarding best practices, constructive suggestions that go beyond professional standards, and matters for the attention of standards setters to be included in the Summary Observations Memorandum in addition to potential findings for the letter of comments.

Governance and Oversight

Overview

The PRC is responsible for administering the SECPS peer review program by establishing standards for conducting and reporting on the results of peer reviews. The PRC also works closely with the POB in its oversight role. Although the AICPA Code of Professional Conduct does not specifically consider relationships between reviewers, reviewed firms, and clients of reviewed firms, the concepts concerning independence, integrity, and objectivity embodied in the Code are critically important to the peer review program. Likewise, oversight of the peer review program by the POB, and the SEC, makes the process both more effective and more credible.

The Task Force concluded that the overall structure for administering and overseeing the peer review program is primarily sound. However, the Task Force believes the effectiveness of future peer reviews would be improved with additional measures to promote peer reviewer independence and objectivity; changes to current protocols among the PRC, POB, SEC, and peer reviewers; and with greater depth in the POB's oversight of the performance of peer reviews.

The Statements on Quality Control Standards (SQCS) issued by the Auditing Standards Board (ASB) provide that firms have a system of quality control for their accounting and auditing practice and broadly describes elements of quality control and other matters essential to the effective design, implementation, and maintenance of the system. These standards, as well as generally accepted accounting, auditing, and independence standards and SEC rules and regulations in areas where such rules and regulations are pertinent, form the foundation of the systems oriented approach to conducting peer reviews. The Task

Force believes that one of the root causes of some recent criticisms of the peer review process relates to the lack of specificity of the SQCS.

Recommendations

4. The PRC should:
 - a. Make changes to the Standards for Performing and Reporting on Peer Reviews for the following:
 - i. Limit the peer review team captains for the reviews of Tier B firms to two consecutive reviews of the same firm and a total of three consecutive reviews as an engagement team member⁴. The primary purpose for limiting the team captain's total years of service is to enhance the benefit of the fresh-look obtained by rotating the peer review team captain.
 - ii. Require that peer review team captains for the reviews of Tier B firms participate in a meeting (exit conference) with the SEC staff and POB staff when the SEC staff reviews the firm's peer review working papers. The purpose of such a meeting is to timely discuss significant matters considered by the SEC staff during their oversight.
 - b. Prepare an annual report for the profession, standard setters (such as the ASB and FASB), regulators (such as the SEC), and others (such as the Professional Issues Task Force and SECPS Quality Control Inquiry Committee) that describes significant matters noted during peer reviews conducted during the year. Such report should highlight matters noted in letters of comments, Summary Review Memoranda, and Summary Observations Memoranda. The primary purpose of the annual report would be to facilitate the timely identification of matters that require the attention of the profession, standard setters, regulators, and others.
 - c. Determine a more formal means of identifying emerging issues and higher-risk areas in a timely manner, and providing frequent updates or supplements to the review materials and questionnaires used to perform peer reviews. The PRC should regularly seek formal input from the ASB, Professional Issues Task Force, SECPS Quality Control Inquiry Committee, POB, SEC staff, and others as to emerging issues and higher-risk areas that should receive focused attention by peer reviewers. The PRC, through a standing committee, task force, SECPS staff or otherwise, should prepare revisions or supplements to its review materials and questionnaires and timely distribute them to peer reviewers. We understand the SECPS is in the process of developing a system for including the review materials and questionnaires on the Internet. The Task Force

⁴ Team captains are currently limited to three consecutive reviews of the same firm with no limit on the total years of service on the engagement team.

supports efforts to make these materials easier to keep current and more accessible to peer reviewers.

- d. Study the cost versus benefit of more frequent peer reviewer involvement for Tier A firms in order to improve the effectiveness of the peer review process for these firms. More frequent peer reviewer involvement might include limited review procedures similar to those described in Recommendation 3 c for Tier B firms.
- e. Establish a more formal means for continuously pursuing better approaches to performing peer reviews. Such means might include, for example, periodically conducting focus group sessions with experienced peer reviewers and users of peer review reports or having a limited number of experienced peer reviewers experiment with different review techniques on some peer reviews.

5. The POB should:

- a. Perform an in-depth review of its current approaches to overseeing the performance of peer reviews with the goal of identifying ways of gaining more timely and deeper involvement by the staff and Board. Guidelines for enhancing such approaches should include the following:
 - i. The nature, timing, and extent of the POB staff's oversight role should vary based on an assessment of such factors as size, complexity, and risk profile of the firm's accounting and auditing practice.
 - ii. The POB staff's oversight of the performance of peer reviews should be timely and include the scope of the review, evaluation and resolution of issues identified during the review, and communications of the results of the review. The scope of the review includes consideration of the number of and specific engagements and offices to be reviewed; the significant accounting, auditing, and independence areas to be emphasized during the review; and the approach to integrating the firm's internal inspection program.
 - iii. The POB staff's oversight of the performance of peer reviews should be more timely and extensive for Tier B firms. More timely involvement would include, for example, increasing beyond its current level the oversight of the work of peer reviewers as it is being performed rather than reviewing the work once it is completed. More extensive involvement would include, for example, participation with a peer reviewer in some interviews of audit engagement team members and in focus group sessions with office personnel.
- b. Consider establishing a process for obtaining additional expertise to assist the POB staff, when necessary, in formulating the staff's views on significant matters that

occasionally arise during the performance of peer reviews. The purpose of establishing such a process would be to provide a means of drawing on experienced professionals and subject matter experts to assist in evaluating matters where significant differences of professional judgment exist between the peer reviewers, reviewed firm, and/or POB staff.

6. The Task Force understands the ASB is planning a project to improve the SQCS. The Task Force believes that an expansion of the standards to include more specific guidance is an important element to achieving continuous improvement and strongly supports the ASB's efforts.

Qualifications and Training of Reviewers

Overview

The Standards for Performing and Reporting on Peer Reviews describes the qualifications and training requirements for peer reviewers. The Task Force believes the standards appropriately address the essential requirements of the peer review team such as confidentiality; independence, integrity and objectivity; competence; organization of the review team; and qualifications for individuals who serve as reviewers and of the reviewing firm. However, the Task Force also believes that the current training courses and approach to training peer review team captains and reviewers needs to be enhanced. There are currently two courses offered by the AICPA to peer reviewers, How to Conduct a Peer Review Under the AICPA Practice-Monitoring Programs ("How to Course") and the Advanced Training Course for Reviewers: Current Issues in Practice Monitoring ("Advanced Course"). Individuals who want to participate as a team captain on a peer review are required to attend a training course at least once every five years. The courses are developed by authors contracted with by the AICPA and are offered through various State CPA societies.

Almost all peer reviews are firm-on-firm peer reviews. However, in a few instances, Committee Appointed Review Teams (CARTs) are formed to perform the review. CARTs are typically formed for reviews of small firms so that the review team has appropriate specialized skills. For example, a CART may have a team captain from one firm and a reviewer from another firm in order to have a review team member who is knowledgeable in a particular specialized industry. Currently, the PRC establishes the fee schedule for CARTs. The Task Force believes a market driven fee arrangement between the CART and the firm being reviewed would result in more qualified reviewers willing to participate on a CART.

Recommendations

7. The PRC should:
 - a. Establish a standing task force that will oversee the peer review training programs to ensure that the training programs and methods of delivering them meet the needs of the peer review program. The task force should address the following:

- i. The content and method of delivering peer review training courses to ensure that the training is relevant and timely. To determine the content of training programs, considerations should be given to the competencies required to perform effective peer reviews. Such competencies would include interviewing skills, diagnostic skills, knowledge of the peer review process, as well as, knowledge of generally accepted accounting, auditing, and independence standards and SEC rules and regulations in areas where such rules and regulations are pertinent to the engagements being reviewed. Also, alternative training methods should be considered such as via the Internet, CD-ROM, or tele-conferencing.
 - ii. The process for identifying and selecting course instructors and for monitoring the instructor's performance should be formalized.
 - iii. Consideration should be given to developing more continuous training programs for team captains.
- b. Develop a system for evaluating the performance of team captains. Such a system might include a written evaluation of the team captain's performance by the SECPS technical reviewer and, when applicable, POB staff for each peer review. The results of such evaluations could then be summarized on a periodic basis to identify team captains who are not performing at an acceptable level so that appropriate actions can be considered by the PRC.
- c. Discontinue setting rates for peer reviews conducted by CARTs. Fees for participating in a CART review should be established by the firm being reviewed and the members of the review team.

Attachment

Task Force Members and Other Participants Peer Review Process Task Force Executive Committee SEC Practice Section of the AICPA

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