AICPA Board of Directors Peer Review Task Force Report:

Recommendations for Enhancing the AICPA Peer Review Programs in a Transparent Environment

February 9, 2006

EXECUTIVE SUMMARY & BACKGROUND INFORMATION

In May 2005 the AICPA Board of Directors established a task force to recommend changes to the profession's peer review programs that would advance the Board's and the AICPA Council's desire for greater transparency of peer review results. The Board agreed that the task force should keep in mind enhancements made to the peer review programs that took effect in 2004 and 2005, as well as the clear movement in the marketplace and regulatory environment toward greater transparency.

The Task Force was chaired by a member of the AICPA Board of Directors and included representation from small, medium and large CPA firms, business & industry, those involved with peer review, some that weren't, state CPA society leadership and regulators.

In evaluating the peer review programs and in making its recommendations, the Task Force was specifically asked to review the results of an on-line poll conducted as a part of the Institute's peer review transparency member awareness initiative. The primary purpose of the poll was to assess members' desire to provide greater transparency of peer review results. However, many of the comments from the 2500 respondents, regardless of their attitudes toward greater transparency, expressed the need for clarification of or enhancements to various aspects of the AICPA peer review programs. (The full text of the charge of the AICPA Board of Directors Peer Review Task Force can be found in the Appendix of this document.)

The Task Force addressed its charge by categorizing into common themes both the comments from the on-line poll and the areas of focus described in its charge. In addressing member input and making specific recommendations, the Task Force also considered the appropriateness of the current peer review model in an era of greater transparency of peer review results.

Background – Moving Toward Transparency

In 1988 AICPA members voted to make peer review mandatory, but to keep the results confidential. Since then, there has been a steady march toward lifting that veil of confidentiality and making peer review results public. Thousands of AICPA firms currently place the results of their peer reviews in a public file as an enrollment requirement in the Center for Public Company Audit Firms Peer Review Program or as a membership requirement of AICPA audit quality centers and the Private Companies Practice Section. In addition, thousands of firms notify the public of the results of their peer review due to governmental or regulatory requirements. Many firms take pride in the results of their peer review and use as a marketing tool. This all contributes to the high public expectations of peer review. Demand for access to the results of peer reviews is at an all time high. Emblematic of that demand are calls from officials of the National Association of State Board of Accountancy for their member boards to have increased access to peer review results. Beyond that, NASBA has proposed the formation of a Compliance Assurance Review Board (CARB) which would shift oversight over peer review from the AICPA and the state CPA societies to NASBA.

Based on the changing business and regulatory environment, the AICPA's governing Council passed a resolution in May 2004 that supports the need for increased transparency of the AICPA Peer Review Program and directed the AICPA Peer Review Board and the staff to assist members in meeting their peer review licensing and reporting obligations. The Council also directed the AICPA staff to launch an education and member feedback effort to describe the regulatory and market environment and to gauge member support for the concept of greater transparency and certain mechanisms for achieving it. There are clearly varying opinions among our members on the specific decisions and actions involved in moving toward greater transparency. Support for the transparency mechanisms as described in the polling instrument was not strong enough to indicate that a referendum on the issue could achieve the two thirds majority needed for the AICPA to overcome the confidentiality covenant that grew out of the 1988 vote to mandate peer review.

With this as background, the Task Force discussed whether making the results of peer review available to a wider audience deserves the continued support of the AICPA. It concluded that greater transparency **is** absolutely the right direction for the profession, but recognized that in order to gain the support of a majority of AICPA members the Institute needs to address member concerns about the peer review process. For that reason, in this report the Task Force is recommending supplemental enhancements and revisions to peer review, as well as additional actions the AICPA should take, such as an expanded peer review communication strategy.

The Task Force believes that greater transparency of peer review results is a demonstration of a CPA firm's commitment to hold itself to high standards and will increase the public's confidence in the CPA profession's core values of competence, integrity and objectivity. We are a trusted profession, and for those firms that have taken on the public interest responsibility of accounting and auditing functions, we must be willing to disclose the independent assessments of CPA firms' practices. After all, if we expect our clients to be transparent in their financial reporting, shouldn't we be equally transparent in communicating the results of our own rules and procedures?

Background – Recent Enhancements

The Task Force views its work as part of a continual review and improvement process by the AICPA to ensure that the peer review programs meet their objectives. The PRB remains committed to designing, implementing and maintaining a preeminent peer review program that monitors the quality of a firm's accounting and auditing practice. In October 2003, the AICPA Peer Review Board (PRB) approved revisions to the AICPA Standards for Performing and Reporting on Peer Reviews (the standards). With these revisions the PRB completed a project of reevaluating the administration, performance, report objectives and overall effectiveness of system reviews as well as engagement and report reviews. The revised standards became effective for peer reviews commencing on or after January 1, 2005. They are available for download at: https://www.aicpa.org/download/practmon/revised_standards_2005.pdf . Interpretations to the standards are also available at: http://www.aicpa.org/download/practmon/prp2005/PRP_24_Text_2.pdf .

The revisions include, among other items, changes to the reporting model, an enhanced risk-based approach for system reviews, and changes to the type and timing of engagement selection.

Along with the issuance of the revised standards, the PRB also published a White Paper which provides background and other pertinent information about the comments received by the PRB from respondents to the exposure draft of the proposed revisions, explains the consideration given to those comments by the PRB, and describes the rationale behind the PRB's adoption of the various provisions in the final standards. The White Paper can be accessed at:

https://www.aicpa.org/download/practmon/2004_03_Whitepaper.pdf .

Readers should note also that the peer review program for members enrolled in the Center for Public Company Audit Firms (CPCAF) also underwent significant changes, primarily to implement the concept of "bridging" from a firm's peer review of their non-SEC issuer work to the PCAOB inspections related to their public company audits. The CPCAF's predecessor, the SEC Practice Section (Section) had also implemented significant enhancements in 2000 which addressed recommendations from what was then the Section's public oversight board.

TASK FORCE RECOMMENDATIONS

1. Create a new reporting model

The Peer Review Board should reevaluate the reporting model, and consider changes that will enhance the understandability and usability of the reports.

2. Enhance annual reporting on oversight

The following reports should be published and their existence widely promoted:

- An annual report issued by the Peer Review Board (PRB) on its oversight of all administering entities.
- An annual report issued by each administering entity on its oversight of its peer review process, including peer reviewers.
- The individual reports issued by the PRB on each PRB oversight visit of the administering entities.

3. Continue and enhance communications to members and external parties

The Task Force recommends that the AICPA continue its peer review communication strategy with members and begin to develop a long-term communication and education strategy aimed at the users of peer review reporting, including consumers of CPA services and regulators.

4. Provide for greater transparency of peer review reports

The Peer Review Board should require administering entities to notify state boards when a firm receives a second consecutive modified or any adverse report.

Moreover, the administering entities should place these peer review results in a state board access file – regardless of state requirements.

5. Create a level playing field for those subject to peer review

The Task Force recommends that all state boards of accountancy should require peer review as a condition of licensure. The Task Force also recommends that all state societies be encouraged to require peer review as a condition of membership.

6. Expand the voluntary public file for all peer reviewed firms

The AICPA should provide a mechanism for members to comply with state board licensing requirements by allowing any AICPA firm to post its peer review results in the AICPA's current public file regardless of membership in a specific AICPA section or audit quality center.

7. Create a program to increase the pool of peer reviewers

The AICPA should conduct a comprehensive recruitment campaign to attract quality peer reviewers. This will include educating firms on the benefits of having their partners and staff members involved in performing peer reviews.

8. Ensure the quality of peer reviewers

The Peer Review Board should continue its efforts to ensure the quality of the peer reviewers and consider additional minimum criteria to be a peer reviewer such as, but not limited to, requiring a minimum number of accounting and auditing hours spent by a reviewer in his or her own firm.

TASK FORCE ISSUES, RECOMMENDATIONS, RATIONALE AND CONCERNS

I. THE APPROPRIATENESS OF THE CURRENT PEER REVIEW MODEL

Issue

Is the current peer review model, which has been primarily remedial and educational since its inception, appropriate for the current environment where a broader range of users, including regulators, place greater reliance on peer review reports? Are there changes to the model that are needed to satisfy the needs of those users? Some members have expressed concern that increasing transparency would move the peer review process more toward a disciplinary and regulatory function.

Recommendations

The Task Force concluded that the current peer review model is appropriate, but its effectiveness could be significantly enhanced through the recommendations in this report, particularly those that seek to achieve greater transparency.

The Task Force recommends that state boards of accountancy be encouraged to require peer review as a condition of licensure for any members in public practice subject to peer review.

It also suggests that state boards of accountancy explore their options to expand access to the peer review results of its licensees.

Finally, the Task Force recommends that state boards recognize peer review as one of the tools, although certainly not the sole tool, to regulate the profession.

Rationale

The Task Force recognizes that when peer review was created, it was intended to be a remedial and educational process to assist members and improve the quality of their accounting and auditing practices. It was not created to assist state boards of accountancy and other governmental entities with their regulatory responsibilities. Over time, as regulators and others have come to rely more on peer review, the peer review process has been enhanced to address the needs of these users as well.

In recognition of the current regulatory environment and the needs of the various users of peer review, the AICPA Peer Review Board and the CPCAF Peer Review Committee recently revised the peer review standards, effective January 1, 2005 and early 2004, respectively. Members, however, may not be aware of these recent enhancements to the peer review process, particularly those that address regulatory concerns.

With these changes in mind, the Task Force determined that the current peer review model is appropriate and can be an effective tool, if used in connection with other regulatory tools, to assist regulators in the regulation of the profession. While the Task Force believes the current peer review model is of high quality, it believes the recommendations included in this report will further enhance the process for all users, including regulators.

Strength of the current model is that peer review for firms performing audits focuses on the firm's system of quality control as a whole and not simply specific engagements. The Task Force encourages governmental entities to rely on and support the current peer review model in performing their regulatory responsibilities rather than developing an alternative process. A single peer review process, even one that is extremely comprehensive, cannot be everything for everyone in an efficient and economically feasible manner.

The Task Force believes that peer review is an outstanding tool, not only for the reviewed firms to improve their practices and users of CPA services to make decisions on who to hire, but also for governmental entities and regulators. The Task Force met with representatives from various regulatory bodies who agreed with the philosophy that while peer review contains very useful information for governmental entities to use as a part of their regulatory efforts, it is not intended to supplant their overall regulatory responsibilities.

Further, the Task Force believes in a level playing field and recognizes the benefits derived from uniformity of state law governing CPA practice. As of this writing 39 state accountancy statutes require peer review as a condition of licensure. Such a provision has long been a feature of the AICPA/NASBA Uniform Accountancy Act. The Task Force therefore recommends that the remaining state boards of accountancy add this provision to their state accountancy statute.

The Task Force also believes that all state boards of accountancy should focus on expanding their options regarding public access to peer review results. It also believes that state CPA societies should be encouraged to require peer review as a condition of society membership.

Concerns

The Task Force recognizes the difficulty of having a peer review model that satisfies the needs of all its users. However, the Task Force believes that with the recommendations in this report, a peer review model can satisfy the needs of multiple users of peer review information, including regulators who can continue to use it as an effective tool in their regulatory process.

II. PEER REVIEW REPORTING MODEL

<u>Issue</u>

Several comments from members in the on-line poll indicated that the current peer review reporting process contains information that is confusing, and in some cases is, misunderstood or misused, either intentionally or unintentionally, by third parties. Specifically, the use of the terms "unmodified," "modified" and "adverse" may have little meaning to certain users, and the inclusion of the Letter of Comment (LOC) as part of the peer review report complicates the general understanding as to whether a firm's practice is good or needs improvement. These matters need to be addressed in light of the growing mandate that the results of peer reviews be made more widely available. This is especially true when peer review reports filed with state regulators, can be accessed by third parties through "freedom of information act" disclosure requests.

<u>Recommendations</u>

The Task force recommends that the Peer Review Board reevaluate the reporting model and consider changes that will enhance the understandability and usability of the reports. Listed below are some directional changes that the PRB should consider:

- Revise peer review reports to be as concise as possible.
- Revise the language in the reports to be as simple as possible and in "plain English," including an explanation of what peer review is and is not.
- To the extent possible, design the reporting language, in system, engagement and report reviews to be as consistent in content and form as possible.

- Change the “grading” process from “unmodified,” “modified,” “adverse,” and “significant comments on a report review” to terminology that is more easily understood by the general public and that clearly articulates the quality of a firm’s practice.
- Since the matters reflected in the LOC do not impact the type of peer review report issued, eliminate the LOC as a part of the current reporting model and communicate those matters to the firm as part of the overall peer review process, similar to how other matters identified in the peer review that don’t impact the nature of the peer review report are communicated.
- Maintain the existing peer review report concept whereby the report is a stand-alone document that discloses the significant matters affecting the type of report issued.

Rationale

In a time of greater transparency, where peer review reports are more widely read by regulators and users of CPA services, the information in the reports must be both understandable and useful. The Task Force believes that recommended changes to the report mitigate concerns that peer review information will be misused or misunderstood by a broader audience and do not reduce the rigor of peer review.

The Task Force believes that in conjunction with other recommendations in this report, a simpler, easier to understand peer review report will not only reduce member concerns about the misuse of information, but also would provide a more valuable tool for all users of the reports.

The Task Force also spent considerable time discussing the role of the LOC in the peer review process. It believes that the Peer Review Board should eliminate the LOC from the peer review reports that are made available to third parties.

Matters that are currently included in the LOC are, by their nature, not of such significance that they impact the type of the peer review report – i.e., unmodified, modified or adverse - issued. They also tend, as members responding to the on-line poll noted, to be inconsistent and not easily understood or out of context. They are certainly not as significant to a firm's overall practice as matters currently directly included in the main body of the report.

The Task Force recognizes that the types of issues normally included in an LOC are still very important to communicate to a firm so it may use the information to improve the quality of its accounting and auditing practice. In fact, the information included in a LOC is more relevant to the reviewed firm than to third parties.

It is important for the public, including governmental entities and regulators, to have access to understandable peer review results that clearly articulate the quality of the CPA firm's practice. The determination as to whether a modified or adverse report is issued is usually much less subjective and more straightforward than determining the matters to be included in a LOC. The information contained in the report should be sufficient for regulators and others to make informed decisions about CPA firms, and should allow regulators to use this information as part of their overall regulatory strategy. Furthermore, the concern of members related to the misuse of peer review information contained in the LOC should be mitigated by its elimination.

Concerns

The Task Force recognizes that simplifying the peer review report will involve several approval processes. Another concern is that many regulators currently have within their standards or rules language references to the LOC that would need revisions. The answer, we believe, is to enlist support for changes to the report, including the elimination of the LOC, from the governmental entities and regulators which use peer review as part of their overall regulatory structure.

The Task Force discussed whether some may interpret these recommendations as being less transparent, since the matters formerly in the LOC would no longer be a part of the reporting process. But the Task Force concluded that based on the nature of the matters that remain in the report, the users of the peer review report will still have the significant information they need to make informed decisions about reviewed firms.

III. OVERSIGHT

Issue

Although members responding to the on-line poll did not directly comment on the oversight process, the Task Force believed that many comments received relating to inconsistencies in the performance among peer reviewers and administering entities are oversight issues. For that reason, the Task Force discussed the following:

- The administering entities' oversight over peer reviewers,
- The AICPA's oversight over the administering entities,
- The state boards' of accountancy oversight relationship with administering entities' peer review committees, and

- A potential alternative oversight structure being contemplated by the National Association of State Boards of Accountancy (NASBA).

Recommendations

The Task Force urges that the peer review programs continue to recognize and promote the importance of oversight as an integral part of the peer review process, including the current relationship many state CPA society administering entities have with independent state boards of accountancy and their oversight bodies. It suggests, however, that the existing oversight processes be made more transparent by communicating the objectives, procedures, and results of oversight to the public without identifying specific individuals or firms. Specifically it recommends:

- The issuance of an annual report by the AICPA Peer Review Board describing its oversight process, the procedures performed with respect to the administering entities and the general results of its oversight for the year.
- The issuance of an annual report by each state CPA society administering entity describing its oversight process, the procedures performed with respect to the reviewed firms and peer reviewers, and the general results of its oversight for the year. This report should include other useful information, such as breaking down the oversight results by such factors as size of firm, the number and types of reviews conducted, as well as a summary of the substandard engagements and actions required to be taken by reviewed firms.
- Reports on the results of the AICPA Peer Review Board state CPA society administering entity oversight visits.

The Task Force further recommends that a plain English description of the oversight process be included as a part of the education strategy discussed throughout this report and include:

- The objectives, structure and process details of oversight.
- The oversight structure and how the process works.
- Targeting the communications to different constituents (tax practitioners, business and industry, education, government entities, and regulators).

Rationale

The Task Force spent significant time discussing the existing AICPA oversight process which has recently undergone several enhancements. The Task Force agreed that the comprehensive nature of the peer review program as well as the fact that a tremendous amount of AICPA and state CPA society resources are spent on the oversight process must be communicated in a clear and unambiguous way to users and potential users of peer review results. The AICPA Peer Review Board recognizes that the current oversight process is critical to the continued success of the Peer Review Program and supports independent state board of accountancy oversight. The primary objective of oversight is to provide a level of assurance that peer reviews are being performed and reported on by qualified independent individuals and administered in accordance with the *Standards for Performing and Reporting on Peer Reviews* and other guidance from the Peer Review Board. Another key objective is to ensure the consistency of reviews in all states and by all reviewers.

The Task Force discussed the nature and extent of the peer review programs' oversight processes in detail, and believed that a general description of that process in this report was warranted. It believes that communicating such a description to users and potential users of peer review results would mitigate many of the concerns related to the potential inconsistencies between different reviewers and in the quality of reviews.

The primary oversight process of the CPCAF Peer Review Program, which is administered by the AICPA, includes sending AICPA staff and consultants out in the field to observe and comment on a percentage of reviews and to perform an on-sight technical review of the peer review and evaluation of the peer reviewer. On certain larger reviews, oversight panels comprised of peer review committee members approve the peer review plan and support the peer reviewer on significant issues that arise prior to it being considered by the CPCAF Peer Review Committee for acceptance. Reviews that are not subject to oversight in the field have a full working paper technical review performed by AICPA technical staff or their consultants. In some cases, concurring technical reviews are required. This all occurs prior to the CPA firm's peer review report (and other related documents) being evaluated and accepted by the peer review committee.

The AICPA Peer Review Program is administered by 41 state CPA societies (administering entities). Each one is required to have its own written policies and procedures for oversight over peer reviews and peer reviewers that adhere to the guidelines established by the AICPA Peer Review Board. The administering entity's oversight process is, in turn, "oversighted" by the AICPA Peer Review Board. Members of the AICPA Peer Review Board or AICPA staff visit each of the administering entities at least once every other year. Annually, a sample of reviews are subject to oversight by AICPA peer review staff. Several administering entities have also entered into an oversight relationship with a state board of accountancy whereby the state board appoints a body to oversee its administration of the AICPA Peer Review Program. The objective is for the oversight body to determine whether the administering entity is complying with the peer review standards and guidance such that the state board of accountancy can rely on the AICPA Peer Review Program to meet its peer review licensing requirements.

The Task Force also discussed NASBA's current initiative, the consideration of an independent national oversight body, possibly similar to its Examination Review Board. The Task Force questioned whether an independent national body would be more appropriate than one at the state level that would likely be more familiar with state laws and regulations. After all, many state boards of accountancy have indicated that their current oversight process is already working well. They are accustomed to writing their own laws and rules, and most state legislatures may not want to turn over oversight responsibility to a national body. The concept was discussed that a national oversight body could develop best practices for individual state boards of accountancy to consider and to assist state boards that do not have an oversight body. However, the Task Force concluded that the current model, where individual state boards are independently assessing how the AICPA Peer Review Program is being administered, is working well. There was limited support amongst the Task Force members for the concept of a single independent national oversight body without having a formal model, including its implementation plan, to assess.

Concerns

The Task Force believes that there is an expectation gap within peer review which can never be completely closed. Some users of peer review results believe that peer review is intended to find every deficiency a firm might have, and that every peer review will be performed, reported on and accepted exactly the same way. Neither of these expectations is realistic. Peer review was never intended to detect every deficiency a firm might have. Furthermore, there are more than 1,700 peer reviewers, 600 administering entity peer review committee members, and 10,000 peer reviews performed annually. While every peer review could not possibly be the same because they all include a level of professional judgment and subjectivity, the Task Force feels that the strong and transparent oversight process helps ensure that reviews are being performed, reported on, and accepted consistently and in accordance with the standards.

IV. COMMUNICATION AND EDUCATION STRATEGY

Issue

If the results of peer review are to be made available to the public, users and potential users of that information must not only be able to understand the information, but the process behind it.

Conclusion and Recommendations

The Task Force recommends that the AICPA continue its peer review communication strategy with members and begin to develop a long-term communication and education strategy targeting the users of peer review reporting, including consumers of CPA services and regulators.

The member communication strategy should be focused on describing the details of the peer review program in a way that enhances the understanding of the program and its features among members.

The user communication strategy should explain the objectives of peer review, what it is and isn't, how the process works, what the reporting means, and the importance of oversight.

Rationale

It is apparent that there are many members, as well as other key users and potential users of peer review results, who are not fully aware of the comprehensive nature of peer review, its benefits, its limitations, and the advantages of making the results of peer review available to the public. A successful effort to enhance understanding of the peer review process will have several beneficial effects. State and federal regulators will better understand the benefits and limitations of peer review, and will be better able to focus their regulatory efforts to achieve maximum efficiency and effectiveness of their overall regulatory programs. AICPA members in business and industry and others in management can use the results of a firm's peer review as a part of their due diligence when hiring an accountant or auditor. This could significantly drive future behavior and make the public appreciate the value of the peer review process. By enhancing value, this could also in turn attract more qualified reviewers.

Concerns

Communicating to many different users and potential users of peer review information is a complicated endeavor that may require extensive financial and human resources. A communication strategy of this magnitude is also not a short-term project. However, the Task Force believes it is a vital part of the successful implementation of the recommendations by the Task Force, the move toward greater transparency, and the effectiveness of the regulation of the profession.

V. GREATER TRANSPARENCY OF PEER REVIEW REPORTING

Issue

The CPA profession has been engaged in a healthy discussion regarding mechanisms for increasing the transparency of peer review reports. Given the current environment, in which regulators and other users are demanding more access to peer review results while members remain divided on the appropriateness of greater peer review transparency, is there a way that users can get what they need while at the same time addressing the concerns of some members?

Recommendations

Although the Task Force believes that all firms subject to the AICPA Peer Review Program should make the results of their peer review information more transparent, it recommends that, at a minimum, the peer review reports of firms which have received a second consecutive modified or any adverse peer review should be made public.

To facilitate this, the PRB should change the process to require administering entities to notify state boards when any firm receives a second consecutive modified or any adverse peer review report, and to provide the appropriate state board of accountancy with access to that information. Because of the AICPA's confidentiality covenant with its members, the Task Force believes this recommendation will require a vote by the membership.

In addition, the Task Force recommends the AICPA move forward with plans to expand the AICPA's current public file system to allow all firms subject to an AICPA peer review to voluntarily post their peer review results without having to become a member of the PCPS or one of the AICPA audit quality centers.

<u>Rationale</u>

While acknowledging that the percentage of firms that will have consecutive modified or adverse reports is low (currently less than 5%), it is nevertheless in the public's interest to make the results of these firms' peer reviews available to state regulators for use in regulating the profession. With the elimination of the LOC, the information posted would likely consist of the peer review report issued by the reviewer, the letter of response by the reviewed firm if applicable, the acceptance letter from the administering entity, and the firm's agreement to take any follow-up or corrective action related to matters contained in the report as a condition of acceptance if applicable. Also, where applicable, included would be the letter from the peer review administering entity informing the firm that the follow-up or corrective action has been completed to the satisfaction of the peer review committee. Several state boards of accountancy already require licensees to submit these documents to them, so for many firms this would not be a change.

Although the concept of a voluntary public file has been discussed in the past, the Task Force believes that with a new reporting model, and in light of the growing number of state boards of accountancy that require remittance of peer review results, many more firms would take advantage of this opportunity – particularly if state boards accept remittance in the form of posting to an accessible and sortable website.

The Task Force also considered the concerns of members that greater transparency would make it easier for peer review information to be used for litigious purposes. However, we found no instances in the 25 years the AICPA has maintained a public peer review file for PCPS and SECPS/CPCAF member firms when the courts have looked to the information in the public file without going directly to the reviewed firm. While the Task Force recognizes that past experience does not necessarily predict future behavior, there is also no indication that there has ever been a claim filed against any member based on a peer review outcome.

Lastly, some members communicated concerns that greater transparency of the results of peer review will be used in a negative way to solicit clients. The AICPA Code of Conduct does not permit a member to use peer review or any other firm information in a false or misleading manner.

Concerns

The Task Force understands that motivating members to participate in a voluntary public file in states with no peer review or submission requirement would be a challenge. More importantly, the Task Force understands that the process of removing confidentiality via a membership ballot process will be an expensive and time-consuming endeavor.

VI. SHRINKING NUMBER OF REVIEWERS AND THEIR AGING POPULATION

Issue

Evidence suggests that there is a declining and an aging population of qualified peer reviewers in the AICPA Peer Review Program.

Recommendation

The Task Force recommends that the AICPA conduct a comprehensive peer reviewer recruitment campaign to attract new, quality peer reviewers and to educate firms on the benefits of having their owners and staff members involved in performing peer reviews.

The recruiting strategy should address the low fees typically charged by reviewers. The task force believes these low fees are a significant contributor to the decline in the numbers of reviewers. The educational campaign should also aim to raise the level of professional respect for reviewers, focusing on the high quality of their work and the requirements that reviewers must meet in order to perform reviews.

Rationale

Exhibits 1 and 2 below approximate the number of peer reviewers and the number of reviews they perform annually. Exhibit 1 includes all peer reviewers, while Exhibit 2 only represents team captains on system reviews (and the equivalent on engagement and report reviews). Since 2001, there has been an approximate reduction of 15% in the total number of peer reviewers.

Exhibits 3 and 4 indicate the number of peer reviewers by age. Since 2001, the number of peer reviewers under the age of 55 has decreased by 28%, and the number under the age of 40 has decreased by 48%. During this same time period, while the total number of peer reviewers has decreased by 15%, the number of peer reviewers over the age of 60 has increased by 35%.

Concerns

The declining number of qualified peer reviewers, and younger reviewers in particular, suggests that in the near future there will be an inadequate number of qualified reviewers to sustain the number of peer reviews performed on an annual basis, unless those reviewers perform more reviews. This will also translate to a shortage in the number of qualified members who serve on state CPA society peer review committees.

Exhibit 1 Total Number of All Peer Reviewers by Range of Number of Reviews Performed

YEAR	1	2	3	4-5	6-10	>10	Total
2001	641	347	213	295	312	292	2100
2002	576	316	225	272	324	350	2063
2003	511	273	218	251	339	340	1932
2004	460	257	192	253	294	337	1793

Exhibit 2 **Total Number of Team Captains (all types of Peer Reviews) by Range of Number of Reviews Performed**

YEAR	1	2	3	4-5	6-10	>10	Total
2001	404	265	194	241	293	268	1665
2002	372	213	190	247	284	321	1627
2003	319	211	186	232	291	312	1551
2004	298	190	155	215	281	305	1444

Exhibit 3 **Number of All Peer Reviewers by Age**

YEAR	<40	40-49	50-54	55-59	60-64	65+	Total
2001	247	877	426	329	137	84	2100
2002	208	814	439	347	156	99	2063
2003	159	701	431	368	175	98	1932
2004	128	583	412	372	204	94	1793

Exhibit 4 **Number of Team Captains (all types of Peer Reviews) by Age**

YEAR	<40	40-49	50-54	55-59	60-64	65+	Total
2001	91	703	368	300	126	77	1665
2002	66	624	379	322	145	91	1627
2003	52	547	371	333	157	91	1551
2004	43	439	355	335	183	89	1444

VII. REVIEWER PERFORMANCE/QUALIFICATIONS AND CONSISTENCY OF PEER REVIEWER PERFORMANCE

Issue

Some of the concerns expressed by members related to the performance of reviewers and their qualifications, as well as inconsistencies in the performance among peer reviewers.

Recommendations

Given member perceptions about the quality of peer reviewers, the Task Force recommends that the Peer Review Board continue to ensure that the quality of peer reviewers remains high. The Task Force believes that the PRB should consider establishing additional minimum requirements to be a peer reviewer such as, requiring a minimum number of annual accounting and auditing hours spent by a reviewer in his or her own firm. The PRB needs to be flexible in measuring those hours, and needs to consider hours spent as an engagement partner, or performing concurring reviews and quality control functions in the firm for example.

The PRB should also continue to issue standards and guidance promoting the training of reviewers, and oversight of that process. The PRB's efforts should be widely publicized as one step towards improving member perceptions about reviewer quality.

Rationale

The Task Force discussed the experience, training and other requirements that reviewers must meet to qualify as a peer reviewer. The Task Force recognizes that consistent, high-quality peer reviewer performance is a critical element to the success of the peer review process. The Task Force believes that recent enhancements issued by the AICPA Peer Review Board, along with the recommendations in this report, satisfactorily address concerns related to peer reviewer performance and qualifications. Accordingly, the Task Force believes that no other changes are necessary specific to the peer reviewer qualification requirements, except for the minimum accounting and auditing hours requirement discussed below.

The Task Force discussed the issue of “peer” versus “professional” reviewers. Most members of the Task Force agreed that, in order to most effectively examine other firms’ practices, reviewers should be practitioners currently applying recent accounting and auditing standards in their own practices as engagement partners, concurring reviewers and in other similar functions. Some members of the profession have also made this argument and that reviewers should be required to spend a minimum number of accounting/auditing hours in their own practices as a requirement to be a peer reviewer. A majority of the task force believes that it would be a very difficult challenge for “professional” reviewers to stay current with the numerous changes that are made each year in accounting and auditing, particularly if they are not applying these issues in their own practices. The review team needs to be proficient in the work performed by the reviewed firm, which is best achieved through the applied knowledge gained through professional experience.

The Task Force also discussed the fact that every peer review goes through some level of administering entity technical review and peer review committee consideration before it is accepted. It is the responsibility of the technical reviewers and the peer review committees to ensure that peer reviewers apply professional standards appropriately and are not "setting" professional standards by requiring a reviewed firm to apply procedures beyond that of professional standards, including quality control standards, or the firm's own policies and procedures when these exceed professional standards, and that the work they perform supports the peer review report and other documents completed by the reviewer. In some cases, reviewers are issued feedback by the administering entity's peer review committee on their performance with corrective measures to improve performance. Depending on the significance and pervasiveness of the problem, a reviewer may be restricted from performing peer reviews. In this case, the restriction is communicated to all administering entities for consideration as part of their own peer review administration and oversight.

Raising the bar on qualification requirements may mean that fewer CPAs might meet those requirements and therefore temporarily reduce the pool of reviewers. However, the task force feels that there is no shortage of CPAs who are qualified to be peer reviewers and that an effective recruitment campaign, as described elsewhere in this report, can overcome any short run drop in reviewers caused by this recommendation.

VIII. SERVICES IN THE SCOPE OF PRACTICE

Issue

Some members raised the question of whether to expand or reduce the current services covered by the peer review process. Currently, engagements performed under the Statements on Auditing Standards, Government Auditing Standards, Statements on Standards for Accounting and Review Services (SSARS), and Statements on Standards for Attestation Engagements (SSAEs) are included in the scope of peer review.

Recommendation

The Task Force recommends no revisions to services in the scope of practice included in the peer review process.

Rationale

The Task Force discussed whether a firm could benefit from having other aspects of its practice peer reviewed and whether there was a compelling public interest to do so. The Task Force agreed that all services performed by a CPA firm are important, and anything peer review could do to improve the quality of practice would always be in the public interest. However, the Task Force discussed the fact that there is a difference between a firm's practice as it relates to services performed that offer some level of implied or actual assurance versus those that do not. The Task Force agreed that both are very important, but believes that the focus of peer review should remain on the aspects of a practice for which assurance is provided (either actual or implied). The Task Force also discussed:

- The lack of measurable professional standards for other areas of practice (tax, management consulting services and litigation support, for example).
- That in most cases one didn't need to be a CPA to perform non accounting and auditing services, and subjecting a firm to peer review for other services would put CPA firms at a competitive disadvantage.
- Given the diversity and specialization of firms and practices, it would be a monumental task to review other aspects of a practice beyond attest and compilation services.
- There appears to be no outcry from the public or state and federal regulators for peer review to cover other aspects of a firm's practice. Many of these areas are regulated in some other fashion.

IX. COVERAGE OF PRACTICE DURING THE PEER REVIEW

Issue

Is the process for selecting the types and number of engagements on a peer review currently appropriate?

Recommendation

The Task Force recommends that no revisions be made to the coverage of practice during the peer review. However, the Task Force does suggest that additional risk assessment guidance be issued to peer reviewers performing reviews of firms with multi-office and multi-state practices.

Rationale

The Task Force focused its discussions on CPA firms with auditing practices. The standards discuss in detail the peer reviewer's risk assessment and the link to engagement selection. On a system review, the peer reviewer gains an understanding of the firm's office operations, in addition to many other aspects of the firm's practice, in order to determine which offices, partners and engagements to cover using a risk-based approach. In addition to covering a reasonable cross-section of the firm's practice, when applicable, all peer reviewers must also select at least one engagement subject to ERISA, one engagement subject to Government Auditing Standards (Yellow Book), and one engagement subject to the Federal Deposit Insurance Corporation Improvement Act (FDICIA). The reviewer must also be able to adapt the coverage of practice based on what is found during the peer review. In this way reviewers use a risk-based approach, while also obtaining a reasonable cross-section of the firm's entire practice rather than focusing solely on a single criteria or percentage coverage of specific industries.

The Task Force also discussed multi-state practices, with an eye toward satisfying state boards of accountancy that a firm's practice in its state is appropriately covered during the peer review when it is administered in a different state. This typically occurs because a review is normally administered in the state where the firm's main office is located. Although the Task Force understands the potential concern related to this matter, it concluded that the existing process discussed here of determining the coverage of practice is appropriate and the benefits outweigh the costs. The Task Force did agree, however, that guidance could be issued to peer reviewers stressing the impact of multi-state and multi-office practices in their risk assessment and as a part of the engagement selection process.

The Task Force also considered that the AICPA Peer Review Program, in addition to system reviews, has about 15,000 firms that undergo engagement or report reviews. These firms don't perform audits or examination level engagements. These are typically very small firms for which 2-4 engagements are selected for the peer review. In these two types of reviews, all those responsible for engagements must have an engagement selected, and all levels of service the firm performs must also be selected. These types of peer reviews do not evaluate the firm's system of quality control.

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Concerns

The peer review process for firms performing audits results in a report that opines on the firm's system of quality control in its entirety. There will always be some who may believe more engagements in their area of interest should be selected or that a peer review should automatically cover a certain percentage of all engagements. The Task Force understands these issues and considered them during its discussions of whether peer review should be a regulatory model. The Task Force has concluded that the risk-based model that considers a reasonable cross section of the firm's practice during the peer review is appropriate.

CONCLUSION

The Task Force believes that by implementing the recommendations in this report, peer review can appropriately serve the needs of users of peer review information in a transparent environment.

The Task Force recognizes that some recommendations within this report are simple and can be implemented quickly, while others are not so easily implemented and may be costly. It also understands that many of the recommendations are dependent on each other for their success The Task Force supports the principle of greater transparency in the reporting of peer review results and believes these recommendations can further the effort to encourage more members to join in that support.

AICPA Board of Directors Peer Review Task Force

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Appendix – Task Force Charge

The charge of the Board of Directors Peer Review Task Force is to:

- Review the verbatim responses to the on-line poll, in light of:
    - the recent enhancements/revisions made to the peer review programs that members may not be aware of
    - the latest changes in the regulatory environment and marketplace that are pointing towards greater transparency
- Determine whether supplemental enhancements/revisions to the peer review programs should be recommended.
- Focus review efforts on:
    - the needs of users of peer review (i.e., firms, clients, regulators),
    - the peer review reporting model,
    - coverage of practice during the peer review,
    - services included in the scope of peer review,
    - reviewer performance/qualifications,
    - consistency of peer review performance and administration, and
    - oversight.
- Not duplicate the reevaluation efforts of either peer review committee.
- Present its recommendations to the Board of Directors in December 2005 and to the peer review committees for consideration in January/February 2006.