An introduction to New York state's mandatory quality review program

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Peer review has long been required of CPA firms that are members of the AICPA and enrolled in its practice monitoring program. In addition, a relatively small number of firms that are not members of the AICPA voluntarily undergo a "non-AICPA" peer review for a variety of reasons. On the other hand, many firms headquartered in New York state that are not members of the AICPA do not voluntarily undergo peer reviews of their accounting or auditing practices. The accountancy reform law of 2009 will soon expand the "peer review" mandate to many of those firms through the mandatory quality review (MQR) program that goes into effect Jan. 1, 2012.

New York State Education Department (SED) MQR regulations specifically authorize organizations that administer peer reviews in New York state to use standards for performing and reporting on peer reviews that have been promulgated by a recognized national accountancy organization such as the AICPA. Accordingly, the terms "peer review" and "quality review" are used interchangeably for the purposes of this article.

CPA firms subject to the MQR regulations

The accountancy reform law requires that every CPA firm that provides attest services in New York state—except most firms with two or fewer accounting professionals—obtain a quality review every three years and submit copies of the report and acceptance letter to the SED. The requirement to be registered and undergo a quality review will also apply to any firm, regardless of the number of accounting professionals, that performs attest services for any New York state governmental agency, performs a governmental or proprietary function for the state or any of its municipalities, or performs "services specifically required to be performed pursuant to New York state law." Sole proprietorships and firms with two or fewer CPAs may also voluntarily undergo a quality review.

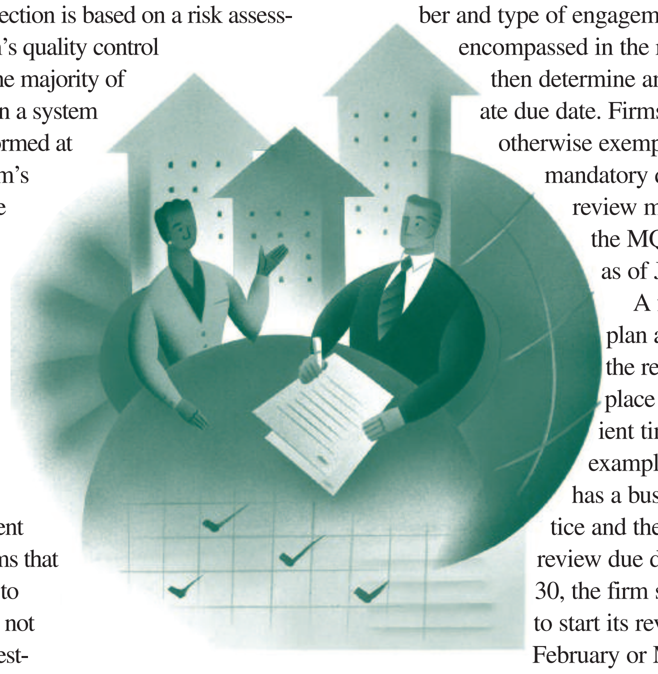
This article will address some of the major questions surrounding the peer review/quality review process, and subsequent articles in the *The Trusted Professional* will look at the new mandatory program in greater detail, particularly as further guidance is issued by the SED.

What are the types of peer review?

Two types of peer reviews exist—the system review and the engagement review. The type of review required is based on the levels of services performed by the firm.

A system review is required of firms that perform engagements under the Statements on Auditing Standards (SASs), the government auditing standards (also known as the Yellow Book), examinations under the Statements on Standards for Attestation Engagements (SSAEs) or audits of non-Securities and Exchange Commission issuers performed pursuant to the standards of the Public Company Accounting Oversight Board. A system review is designed to determine whether a firm's policies and procedures underlying its system of quality control for its accounting and auditing practice is designed in such a way and adhered to in order to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.

In a system review, the reviewer analyzes and evaluates a CPA firm's quality control policies and procedures in effect during the peer review period, through such techniques as interviewing firm personnel and examining administrative files. To evaluate the effectiveness of the quality control system and the degree of compliance with the system, the reviewer will test a cross section of the firm's engagements, with a focus on high-risk engagements. Engagement selection is based on a risk assessment of the firm's quality control environment. The majority of the procedures in a system review are performed at the reviewed firm's office, unless the reviewer has requested and received prior approval from the administering entity to have the review performed elsewhere.



An engagement review is for firms that are not required to have—and have not voluntarily requested—a system review. The objective of an engagement review is to evaluate whether engagements are performed and reported on in conformity with applicable professional standards in all material respects. An engagement review consists of reading the financial statements or information submitted by the reviewed firm and the accompanying accountant's report, together with certain background information and representations and applicable documentation required by professional standards.

This type of review does not cover the firm's system of quality control, so the reviewer does not express any assurance on the firm's compliance with AICPA-issued quality control standards.

Who administers my peer review?

The NYSSCPA expects to apply to the SED to be an approved sponsoring organization, once the SED has finalized its sponsoring agreements. The NYSSCPA currently administers the AICPA's peer review program.

How can a firm enroll in the NYSSCPA peer review program?

A firm should submit an "NYSSCPA Peer Review Program Enrollment Form," available at http://www.aicpa.org/InterestAreas/PeerReview/Membership/DownloadableDocuments/EnrollmentForm.pdf, to the NYSSCPA. By enrolling, a firm agrees to have a peer review of its accounting and auditing practice once every three years.

Once enrolled, when should a firm have its first peer review?

Under AICPA peer review administrative provisions, a firm's initial peer review ordinarily must be submitted to the administering entity (MQR regulations use the term "sponsoring organization") no later than 18 months from the date it enrolled—or should have enrolled—in the program. The sponsoring organization will consider the type of practice, the year-ends of its engagements (or year-end of its initial engagement), when the engagements were performed, and the number and type of engagements to be encompassed in the review, and then determine an appropriate due date. Firms that are not otherwise exempt from mandatory quality review must enroll in the MQR program as of Jan. 1, 2012.

A firm should plan ahead so that the review takes place at a convenient time. For example, if a firm has a busy tax practice and the peer review due date is April 30, the firm should plan to start its review in February or March, to ensure that the review is completed in a timely fashion.

What quality review documents must be submitted to the SED?

1) A report issued by an SED-approved reviewer;

2) An acceptance letter from a sponsoring organization;

3) For firms receiving other than a Pass Report:

a) The firm's letter of response.

b) The report and acceptance letter as in 1 and 2.

c) A copy of a conditional acceptance letter signed by the firm agreeing to corrective action.

d) A sponsoring organization letter notifying the firm that required actions have been completed.

When are these documents due at the SED?

- The documents described in 1, 2 and 3a should be provided by the sponsoring organization within 30 days of the date of the acceptance letter.
- The document described in 3c should be filed within 30 days of the date that the firm signs the letter.
- The document described in 3d above should be filed within 30 days of the date the firm signs the letter.

If the sponsoring organization cannot provide these documents to the SED, then the firm should provide copies of the applicable document(s) within 10 days of receipt.

How does my firm schedule a peer review?

Once a firm enrolls in the peer review program, the administering entity will send a letter to the managing partner of the firm regarding the firm's peer review due date.

The managing partner will be contacted by the NYSSCPA at least six months prior to the review due date or as soon as reasonably possible, and be asked to provide information such as, but not limited to—

- whether the firm has an accounting, auditing or attestation practice as defined in the AICPA's *Standards for Performing and Reporting on Peer Reviews;*
- whether the review is to be performed by a team appointed by the administering entity, by an authorized association or by a qualified firm;
- the areas in which the firm practices and any industries in which more than 10 percent of the firm's auditing practice hours are concentrated;
- whether the firm performs any audits through a joint venture or partnership arrangement;
- the anticipated timing of the review; and
- the reviewer(s) selected to perform the review, if the firm chooses to select its own review team formed by qualifying firms.

The firm will be asked to provide this information on the "Information Required for Scheduling Reviews" form, and to sign and return the form to the NYSSCPA or its administering entity. If the information regarding the review team members is not known, the information can be provided at a later date, but as soon as reasonably possible to ensure that the chosen reviewers are qualified and are approved by the administering entity.

Can a firm change its peer review year-end date?

A firm is expected to maintain the same 12-month peer review period on subsequent peer reviews. Circumstances may arise that may cause a firm to want to change its year-end. For example, the nature of the firm's practice may change or it may reevaluate its current year-end and determine that a different year-end would be more practical. In such situations, a firm may change its year-end only with prior, written approval of the sponsoring organization.

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Will information about my firm obtained during a peer review and the peer review report receive confidential treatment?

A peer review must be conducted in compliance with the confidentiality requirements set forth in the AICPA Code of Professional Conduct. Information concerning the reviewed firm or any of its clients or personnel that is obtained as a consequence of the review is confidential. Peer reviewers may not disclose such information to anyone who is not involved in carrying out the review or administering the peer review program, or use such information in any way not related to meeting the objectives of the program. Reviewers do not have contact with clients of the reviewed firms.

The NYSSCPA does not make the results of a peer or quality review available to the public, except as authorized or permitted by the firm. A firm may authorize the release of its review if it is a voluntary member of one of the AICPA's audit quality centers or sections that has a membership requirement that certain peer review documents be open to public inspection. Unless a firm opts out of the Facilitated State Board Access program (see the discussion later in this article), certain peer review information may be shared with the state accountancy board of the firm's home state.

What is Facilitated State Board Access (FSBA) and how might it affect access to information about a firm's peer review?

FSBA is a process intended to create a nationally uniform system through which CPA firms can satisfy state board or licensing body peer review information submission requirements, increase transparency and retain control over their peer review results. Depending on a state's requirements, laws and regulations, a firm may have the ability to opt out of this process, and a firm's peer review results may or may not be made available to a state board of accountancy as a result of this process. Under MQR in New York, a firm is required to submit certain quality review documents to the SED as described above, and it is expected that FSBA might satisfy that requirement.

What if there is a change in the level of services performed by my firm's practice?

A firm should notify its peer review administering entity, in writing, of any change in its practice so that the appropriate type and timing of the firm's next peer review can be determined.

How much will a peer or quality review cost?

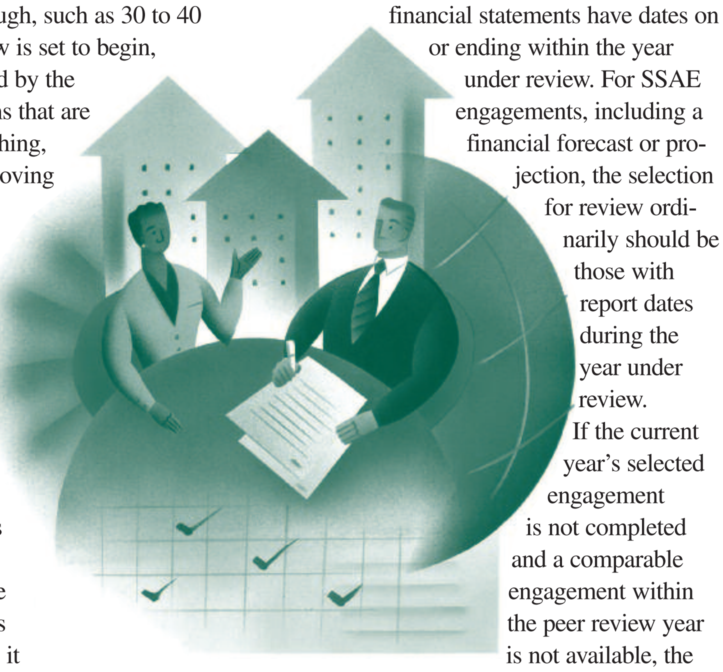
The cost varies based on the type of peer review and peer review team selected to perform the review. In addition to review costs that are incurred every three years, firms also pay an annual administrative fee to the administering entity to cover the costs of running the program.

The direct cost of a system review varies depending on firm size and region, the number of engagements/partners/offices and the nature of the firm's accounting and auditing practice. Firms with audits in various specialized, complex or high-risk industries, such as banking, governmental and employee benefit plans, would normally pay more for a peer review than a firm with the same number of audits that specializes in one or a few industries only, or in lower-risk industries. There may be other factors that influence the cost of a system review, including the complexity and design of, and compliance with, the firm's quality control system.

The estimated cost of an engagement review varies based on the size of the practice and the number of owners responsible for the issuance of review, compilation and attestation engagement reports.

Are there ways to reduce the costs of my peer review?

Yes. The best way to reduce costs is to provide complete, accurate information to the reviewer(s) early enough, such as 30 to 40 days before the review is set to begin, so it can be completed by the review due date. Firms that are committed to establishing, maintaining and improving the quality of their accounting and audit practice tend to have a more efficient peer review. If procedures and conclusions are properly documented in effectively organized engagement work paper files and the firm's quality control documents are properly tailored to its practice environment, it will enhance the reviewer's ability to perform review procedures more efficiently.



How is a reviewer selected?

A firm may identify a CPA firm to conduct its review, which gives the firm a degree of assurance that the reviewer's qualifications match the firm's practice levels and industry specializations. The reviewing firm is subject to matching and approval processes by the administering entity/sponsoring organization under both the AICPA program and MQR, to provide that same assurance that a reviewer is appropriately qualified.

What questions should be asked when selecting a reviewer to perform a peer/quality review?

- How many reviews has the individual or team performed?
- How much experience does the reviewer have in the industries in which the reviewed firm performs?
- Will the reviewer be able to complete the review on time, allowing enough time for the reviewed firm to submit the report and letter of response, if any, to the administering entity by its review due date?
- Are there any other value-added services that the reviewer can provide a firm during the peer review process?
- What type of government and/or ERISA audits are performed by the firm (if applicable)?
- Does the reviewer meet all of the qualifications to be a peer reviewer?
- Has the ability to be a reviewer been limited or restricted or has the reviewer received notifications of limitations/restrictions on its ability to practice public accounting by regulatory, monitoring or enforcement bodies?

What period should my firm's peer review cover?

The peer review covers a one-year period and is determined based upon the month in which the firm becomes subject to mandatory quality review. A firm with one or more owners who do not meet the experience requirements (1,000 hours of audit, review or compilation experience over five years) could opt to have a peer review for the one-year period ending on the last day of the month it issued its first report on an attest engagement.

Engagements selected for review in a system review would generally be those whose financial statements have dates on or ending within the year under review. For SSAE engagements, including a financial forecast or projection, the selection for review ordinarily should be those with report dates during the year under review.

If the current year's selected engagement is not completed and a comparable engagement within the peer review year is not available, the prior year's engagement should be reviewed. If the subsequent year's engagement has been completed, the peer review team should consider, based on its assessment of peer review risk, whether the more recently completed engagement should be reviewed instead.

What if my client does not want its financial statements and related information reviewed by the peer reviewer?

Firms may have legitimate reasons for excluding an engagement from the scope of peer reviewers—for example, if the engagement is subject to litigation or the client will not permit the firm to make the engagement available.

In these situations, the reviewed firm should submit a written statement to the NYSSCPA or other administering entity, prior to commencement of the review, indicating that it plans to exclude an engagement(s) from the peer review selection process, the reasons for the exclusion and that it is requesting a waiver from a scope limitation in the peer review report. The administering entity will decide if the reviewed firm's request to exclude an engagement is reasonable and whether the firm should receive an exemption from the scope limitation report.

Some other frequently asked questions

Q: Am I or my firm subject to mandatory quality review if we have no accounting or auditing practice?

A: *No, you are not subject to mandatory quality review.*

Q: Am I or my firm subject to mandatory quality review if my firm's practice is limited to full-disclosure compilations, compilations that substantially omit all disclosures and compilations issued with engagement letters but without an accountant's report?

A: *No.*

Q: My firm has been enrolled in the AICPA program for a number of years, and its peer review acceptance letter was dated Feb. 20, 2011. The peer review covered the 12-month period ending Sept. 30, 2010. Does my AICPA peer review satisfy the requirements of the mandatory quality review law for 2012?

A: *Yes, at present, it is believed that the SED will not require a second peer review of a firm if such firm has received a peer review report with a rating of "pass" or "pass with-in deficiencies" covering a period that falls within 18 months prior to Jan. 1, 2012. In that case, the firm would be required to have its next quality review completed no later than March 31, 2014 (six months after the end of its 12-month peer review period ending on Sept. 30, 2013).*

Q: Is my firm, which is headquartered outside New York state but performs attest services within New York state, subject to the mandatory peer review provisions?

A: *Yes. However, such a firm may satisfy that requirement if it is currently enrolled in the AICPA peer review program or a similar program promulgated by a recognized national accountancy organization and submits a peer review with a rating of "pass" or "pass with deficiencies."*

Q: My firm's triennial registration is due in 2011. Which services qualify toward the requirement of 1,000 hours of experience over five years?

A: *"Attest" services (audit, review and engagements under the SSAEs), reporting on financial statements through employment in government, private industry, public practice (full disclosure and selected disclosure compilations and compilations that omit substantially all disclosures) or in an educational institution satisfactory to the New York State Board for Public Accountancy.*

Additional information about New York state's mandatory quality review and competency regulations will be published periodically in *The Trusted Professional.*

How can I find out more about the AICPA peer review program and the New York state quality review program?

The NYSSCPA peer review website, at http://www.nysscpa.org/prof_library/peerreview.htm contains links to resources for peer reviewers, CPA firms and the public.

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