Proposed Evolution of Peer Review Administration
Revised January 2017

A discussion paper seeking input from state CPA societies and state boards of accountancy

Background

In February 2016, the American Institute of CPAs (AICPA) released a discussion paper to state CPA society (society) CEOs to solicit input on the evolution of peer review administration of the AICPA Peer Review Program (Program), with a companion paper sent to state boards of accountancy (boards) in July. The evolution of peer review administration is part of the AICPA's [Enhancing Audit Quality](#) (EAQ) initiative, with the objective to ultimately improve audit performance by increasing consistency, efficiency and effectiveness of Program administration.

The February paper proposed a model for a peer review administering entity (AE) of the future, specifying various criteria, including a required number of AEs, specific staffing requirements/qualifications, structural requirements for Peer Review Committees (Committees) and Report Acceptance Bodies (RABs) and the administration of a minimum of 1,000 peer reviews annually. The model demonstrated one potential way in which the consistency, efficiency and effectiveness in the administration of peer review could be increased, resulting in improved audit performance by practitioners.

The discussion paper and its companion paper to the boards generated significant discussion and response, including formal comment letters from 30 societies and 25 boards. The overwhelming majority of respondents agreed inconsistencies exist among AEs and the administration model needs to change. Most respondents agreed a reduction in the number of AEs would improve consistency.

In addition, stakeholders submitted ideas on how best to achieve the stated objective including several alternatives to the model. A group of society staff leadership and AICPA staff carefully considered these alternatives, and agreed that a model using modified staffing requirements/qualifications and specific performance benchmarks could most effectively achieve the objective. In addition, the Planning Task Force of the AICPA's Peer Review Board (PRB) provided additional input while concurring with the approach as a whole. **Based on this feedback, the model has been revised to eliminate the required number of AEs, the requirement to administer a minimum of 1,000 reviews annually and many of the AE staffing requirements.**

Proposed Benchmark Model

The most common suggestion for the evolution of peer review administration was to allow existing, effective AEs that operate in full accordance with Program Standards and guidance, to continue administering the Program, without consideration given to the number of peer reviews administered, and to discontinue administration by poor performing AEs. Many respondents indicated they believed their AE was operating effectively because they were unaware of any evidence to the contrary. **Accordingly, the model proposed in this paper requires AEs to meet specific benchmarks, diligently monitored by the AICPA, and increases transparency of AE performance.**

Under this model, AEs that choose to continue administering peer reviews must meet specific benchmarks, which include qualitative, objective and measurable criteria. AEs will be evaluated based upon whether they consistently meet these benchmarks. AE performance will be made transparent through new reporting requirements to various stakeholders, such as society CEOs and boards, as appropriate. If this approach is undertaken, the specific benchmarks illustrated in this paper are subject to changes and approval by the PRB, and may be modified over time due to advances in technology and other factors.

Inconsistencies in administrative processes and report acceptance have been identified by PRB Oversight Task Force (OTF) members and AICPA staff through RAB observations, AE oversight visits and other processes. These inconsistencies, though communicated only to the AE in the past, resulted in peer reviews being administered untimely and with results not in compliance with the Program. The proposed benchmarks have been developed by identifying how to:

- Minimize the inconsistencies
- Increase the probability that individuals with the appropriate knowledge, experience and skepticism perform and give adequate consideration to technical reviews and the RAB process, and
- Optimize the peer review process so firms can meet their licensing requirements efficiently

Two Important Criteria Retained and Modified

Two key criteria from the original proposed model are included, though slightly modified, in this revised proposal related to staffing and Technical Reviewer requirements.

1) Staffing: Ultimately, the society CEO is responsible for determining the necessary staffing and hiring appropriately qualified individuals.

   Though the primary focus of the proposed model is the achievement of identified benchmarks, each AE will be required to have at least one CPA employed on staff, who is actively engaged, knowledgeable about the Program Standards and administrative requirements and processes, and has the authority and sufficient knowledge to identify and correct inadequate performance of an administrator or technical reviewer. If the AE administers for more than one state, the CPA staff member must be employed full-time. This individual should
   - Be fully committed to the objectives of the Program and its administration and have the moral courage to challenge Committees/RABs, when necessary
   - Conduct monitoring procedures and present results to the society CEO
   - Be responsible for day to day operations of the Program, which allows continuity and a backup plan

2) Technical Reviewer Requirements: Based on stakeholder feedback the requirement for a full-time technical reviewer to be employed on staff has been removed. Additionally, the requirement that all working papers be evaluated as a part of the technical review has been removed. However, there will be a change in process in that administrators will make all peer review working papers available to the technical reviewer who will be required to take a risk-based approach in determining which working papers should be evaluated during the technical review. In addition, the requirement for the technical reviewer to be present during RAB meetings has been retained.

Failure to Meet Benchmarks

If performance benchmarks are not met, a society (or organization) will lose its ability to be an AE. The OTF and AICPA staff will monitor AE compliance through reports generated from the new peer review software program launching in 2017, Peer Review Integrated Management Application (PRIMA), observations of Committee and RAB meetings and AE oversight visits. If an AE fails to meet the benchmarks and appropriate, timely remediation is not achieved, the

PRB will rescind the AE's ability to administer the Program. Fair procedures will be developed and followed to determine the appropriate remediation and, if necessary, termination.

Benchmarks

Benchmarks fall into three categories: administrator, technical reviewer and Committee/RAB. AEs will be required to develop policies and procedures to address how the AE will comply with the benchmarks. These policies and procedures will become part of each AE's annual Plan of Administration (POA). The POA is a document outlining operational details as to how the AE will implement the Program under Program Standards and is subject to annual approval by the PRB.

In addition, each AE will be required to develop and disclose in its POA its policies and procedures designed to mitigate the familiarity threat that exists among Committees/RABs, technical reviewers, peer reviewers, and firms subject to review, based on the AE's particular circumstances. Such procedures may include one or more of the following (not all inclusive):
- Redacting identifying information about firm and/or peer reviewers from documents presented to RAB
- Arranging for the acceptance of its committee members' peer reviews by another AE
- Arranging for the acceptance of its high-volume reviewers' reviews by another AE
- Arranging for RAB members or specialists from other states to participate in RABs
- Engaging qualified individuals from another state to perform all technical reviews

In addition to the policies and procedures designed to mitigate the familiarity threat developed by each AE, all committee and RAB members will annually be required to: (1) participate in guided discussion which will emphasize the importance of maintaining objectivity and the appropriate level of skepticism, and (2) sign confirmations indicating their agreement to comply with Program Standards and maintain objectivity and an appropriate level of skepticism.

For each AE, the applicable society CEO(s) will be accountable for the peer review administrative process under his/her organization's responsibility. Accordingly, the CEO will be responsible for:
- Determining the necessary staffing
- Hiring appropriately qualified individuals
- Monitoring compliance with the benchmarks, and
- Signing the POA, agreeing to the responsibilities outlined above

See Exhibit 1 for descriptions of proposed benchmarks.

Benchmark Violations and Fair Procedures

If an AE fails to meet the required benchmarks, fair procedures will be followed to determine the appropriate remediation, or depending on the significance of the benchmarks not achieved, termination. The fair procedures developed will provide the AE an opportunity to remedy the situation(s) that created the violation(s), with disqualification as an AE resulting only from a failure to remediate to acceptable levels of performance. When remediation is required, the individual within the AE responsible for the Program should immediately take required actions, and the society CEO should oversee the remediation.

Violations will fall into one of two categories: egregious and non-egregious, with both types of violations resulting in required remediation and appropriate transparency to stakeholders. A pattern of non-egregious violations will result in additional oversight, with failure to remediate causing the AE to move into "probation." Egregious violations will cause immediate "probation," with the AE incurring the cost of external oversight during remediation.

Exhibit 2 provides a flow chart and an illustrated example of fair procedures. The fair procedures will be fully developed and shared with all stakeholders, including the costs to the AE for remediation and probationary activities.

As previously indicated, the specific benchmarks illustrated in this paper are subject to changes and approval by the PRB, including the determination of which benchmark violations are considered egregious. Below are examples of proposed egregious benchmark violations which will cause an AE to move into probation:

- Late submission of the Annual POA (or not including all required information) by due date (note that the PRB is currently considering revising the due date of the Annual POA to a time where submission of complete information is reasonably achievable)
- Not completing the required annual minimum number of oversights by the due date (note that, similar to the consideration noted above for the Annual POA, the PRB is currently considering the date by which all oversights must be completed.)
- Not addressing reviewer performance issues timely
- Technical reviewer and Committee/RAB members not applying appropriate level of objectivity and skepticism (familiarity threat)
- Receiving repeat comments in a RAB observation report from the immediate preceding report
- Releasing confidential peer review information to an external party without written permission from firm
- Sending over 15% of required communications late
- RABs accepting reviews without the presence of members who have appropriate experience/expertise or a quorum
- Not performing administrative oversight
- RAB consistently deferring or delaying over 10% of reviews
- Not engaging/using technical reviewers who possess appropriate experience, training or expertise
- Technical reviewers not present at RAB meetings
- Not structuring and scheduling RAB meetings appropriately
- Not responding timely to requests from the OTF or AICPA staff

State Board Oversight

While this paper does not propose a separate set of board oversight benchmarks, **such oversight will continue to be a critical component of the Program's administration**. The proposed model will not be effective without external oversight such as that performed by board-appointed Peer Review Oversight Committees (PROCs). We will continue to work closely with the National Association of State Boards of Accountancy (NASBA) and boards to support an effective PROC process. We will also continue our collaboration with NASBA's Compliance Assurance Committee (CAC) to discuss and develop appropriate oversight procedures.

In addition, we will create a panel of board executive directors as an additional channel of input for administrative matters. Through this model, we will provide an additional avenue of discussion regarding AE administration and other peer review matters.

Stakeholder Feedback Requested by June 30, 2017

Feedback is integral to the evolution of peer review administration. The AICPA is requesting your feedback of this proposed model and the benchmark criteria for AEs of the future. All input will be considered and will shape the final plan. The intent is to communicate a final plan, along with a transition process, by August 31, 2017.

Please consider the following questions when formulating your response.
- Considering the benchmark criteria presented, what changes do you believe will best increase consistency and audit quality in the peer review administration process?
- What suggestions do you have to help mitigate familiarity threats to the process?
- Are there proposals within this paper that are not feasible? If so, what suggestions do you have for otherwise meeting the objective of increasing consistency, efficiency and effectiveness of Program administration?
- Considering the benchmark criteria presented, would any new criteria be unreasonable to implement by May 1, 2018?
- Are there additional benchmark criteria that should be included?
- Are there aspects discussed within the paper that need further clarification?

If you have concerns about aspects of the proposed plan, please share alternative suggestions for meeting the quality initiative.

Comments and responses should be sent to Beth Thoresen, Director – Peer Review Operations, AICPA Peer Review Program, AICPA, 220 Leigh Farm Road, Durham, NC 27707-8110 or [prsupport@aicpa.org,](mailto:prsupport@aicpa.org) and are requested by June 30, 2017.

Thank you in advance for your thoughtful consideration of the issues facing Peer Review administration, and your commitment to enhancing audit quality throughout the profession.

Exhibit 1 – Benchmarks

The following are proposed performance benchmarks for which each AE will be held accountable. All benchmarks in this paper are illustrative and are subject to modification and approval by the PRB. The OTF and AICPA staff will monitor compliance utilizing PRIMA, observations of Committee and RAB meetings and AE oversight visits.

Some benchmarks may require changes to guidance and others may be revised as PRIMA is implemented during 2017. Current benchmarks will be monitored upon approval of the concept. Certain benchmarks are currently implied and thus expected to be currently met, and guidance will be changed such that they will be explicitly required. Benchmarks that are not currently implied or required will be phased in, with all benchmarks effective by May 1, 2018.

<u>Administrator Benchmarks:</u>

Current Requirements
- Enter committee decision for reviews when acceptance has been delayed or deferred and send letters within two weeks of RAB meetings
- Submit complete annual POA by due date, including completion of all requirements
- Select appropriate reviews for oversight based on written criteria in the policies and procedures, which considers risks associated with both the reviewer and the firm
- Ensure the minimum number of oversights and the related criteria are met and performed throughout the year
- Send overdue letters and other communications when appropriate as required by guidance
- Make appropriate decisions on exceptions (e.g. extensions, team members, off-site reviews, etc.) and maintain support for exceptions
- Perform the reviewer resume verification process timely and in accordance with the Oversight Handbook
- Follow the documentation retention criteria policy established within Interpretation 25-1

Implied Requirements
- Comply with confidentiality requirements of the Program and the boards for the states the AE administers; this includes:
  - Establish internal confidentiality procedures
  - Communicate the policies and procedures to all parties involved in the peer review administration process
  - Observe that the policies and procedures are followed
- Complete administration checklist and record working papers received (within four business days of receipt)
- Fully implement recommendations from RAB observations in a timely manner upon receipt of the report
- Fully implement recommendations from RAB observations such that no comments are repeated in subsequent observations
- Provide RAB materials electronically to RAB members one week in advance of RAB meetings
- Respond timely to requests from the OTF or AICPA staff

New Requirements
- Weekly investigate reviews for which review team composition can't be approved
- Record committee decisions timely in PRIMA after RAB meetings for reviews that are accepted which will result in documents being uploaded to FSBA
- Address the familiarity threat for Committee and RAB composition within the POA

Technical Reviewer Benchmarks:

Current Requirements
- Perform the technical review timely and in accordance with the RAB Handbook requirements (including applying appropriate levels of objectivity and skepticism)
- Recommend reviews or engagements for oversight when appropriate

Implied Requirements
- Limit reviews with open items and missing relevant information from being included in the RAB package unless RAB consultation necessary (overall over time, an AE should have less than 10% of its reviews delayed or deferred to another meeting)
- Fully implement recommendations from RAB observations in a timely manner upon receipt of the report
- Fully implement recommendations from RAB observations such that no comments are repeated in subsequent observations
- Be familiar with guidance issued by the PRB and the board licensure laws for the states in which the AEs administer peer reviews
- Propose due date for corrective actions or implementation plans after discussing feasibility with the firm in advance of RAB meeting to be included in the RAB materials
- Respond timely to requests from the OTF or AICPA staff

New Requirements
- Prepare reviewer feedback forms and letters in advance of RAB meeting to be included in the RAB materials
- Obtain must-select training to perform technical reviews of peer reviews that have engagements from must-select industries
- Be present during RAB meetings in which his/her reviews are presented to answer RAB member questions to avoid deferrals or delays
- Be CPAs
- Thoroughly prepare peer reviews for RAB meetings to minimize the number of reviews that are deferred or delayed accepted subject to missing information

Committee/RAB Benchmarks:

Current Requirements
- Conduct RAB meetings with sufficient frequency to meet 120-day rule for timeliness of presentation of reviews (60-day rule for engagement reviews with certain criteria)[1]

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[1] This model does not propose a minimum number of RAB meetings per year.

- Structure each meeting's RAB member composition to include members with relevant industry experience (regarding must-select engagements)
- Ensure each review has a quorum of RAB members to vote on it in accordance with the RAB Handbook
- Be familiar with guidance issued by the PRB
- Meet qualifications as established in the RAB Handbook
- Read materials prior to the RAB meeting and come prepared to discuss agenda items
- Discuss peer reviews and do not overly rely on the technical reviewer (including applying appropriate levels of objectivity and skepticism)
- Assign corrective actions and implementation plans in the appropriate situations with due dates that are feasible and will benefit the firm
- Issue timely the appropriate level of reviewer feedback that the situation dictates
- Shepherd reviews through the completion process timely, including generally not waiving or extending corrective actions and implementation plans (exception – hardships)
- Perform oversights on firms and reviewers timely in accordance with the Oversight Handbook and each AE's own written policies and procedures
- Annually evaluate qualifications and competencies of technical reviewer(s)
- Perform administrative oversight in accordance with the Oversight Handbook

Implied Requirements
- Establish RAB meeting length so that the entire meeting is productive; the length is appropriate to adequately discuss each peer review given its complexity (suggestion: conference calls should not be scheduled for more than two hours)
- Fully implement recommendations from RAB observations in a timely manner upon receipt of the report
- Fully implement recommendations from RAB observations such that no comments are repeated in subsequent observations
- Respond timely to requests from the OTF or AICPA staff

New Requirements
- Schedule RAB meetings no later than two weeks in advance
- Establish a written RAB rotation policy regarding RAB composition within the POA
- Ensure an oversight plan is approved by the Committee and is in place by a required date
- Present pertinent facts on each review (not on the consent agenda) prior to discussion and voting
- All RAB members will formally attest to having read all materials prior to RAB meeting and will maintain objectivity and a professionally skeptical attitude when considering reviews presented for acceptance.

Exhibit 2 – Fair Procedures

If an AE fails to meet the established benchmarks, fair procedures will be followed. The anticipated process will include multiple steps, including required remediation and, if remediation is not successful, termination of the AE's qualification to administer the Program.

Process Flow:
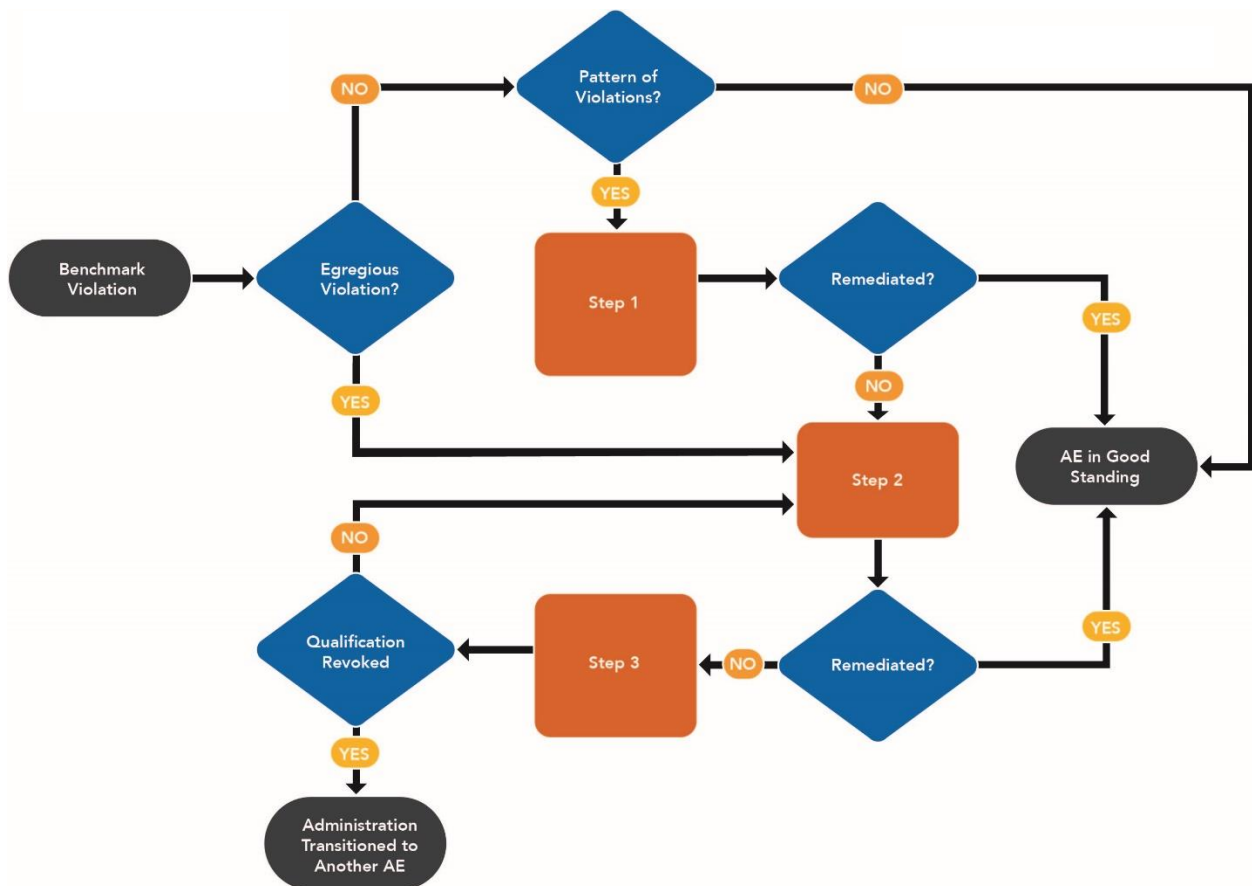
Steps in Fair Procedures:

Step 1: Increased monitoring performed remotely by AICPA staff. Determination to move to Step 1 made by AICPA staff, with periodic reporting of activity to the OTF.

- Accelerated RAB observations to include all reviews presented to RAB. (Second RAB observation to occur no sooner than 30 days after the first.)
  - o Procedures include reviewing RAB materials, observing the RAB meeting and preparing the report.
- Monitor status of open reviews monthly during this period.

Step 2: Probation – increased monitoring performed by AICPA staff and/or OTF member at AE's expense, which may include on-site oversight at an appropriate hourly rate and reimbursement of travel expenses. Determination to move to Step 2 made by OTF.

Step 2 Example: Below are activities that may occur with increased monitoring during the probation period. Multiple activities, including repetitions, may be required, and could cost the AE anywhere from $10,000 to $40,000. Note, however, that actual hours, rates and resulting costs may vary greatly.

- RAB meeting observation – procedures include reviewing materials, observing the meeting and preparing a report to the OTF (time estimate – 5 hours)
- Test AE's compliance with administrative procedures (time estimate – 4 hours)
- Committee meeting observation (time estimate – 4 hours)
- Travel to AE for in-person observation (time estimate – 4 to 10 hours)

Step 3: Referral to hearing panel to determine whether:

- The AE's qualification to administer the Program will be terminated (with its administration transitioned to another AE), or
- The AE will be allowed to continue to remediate (i.e., return to Step 2).