

Public Oversight Board

Annual Report 1981-82

Public Oversight Board
SEC Practice Section
Division for CPA Firms
American Institute of Certified Public Accountants

Public Oversight Board

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William L. Cary

John D. Harper

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Public Oversight Board

SEC PRACTICE SECTION

American Institute of Certified Public Accountants

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June 30, 1982

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To Member Firms of the SEC Practice Section,
Securities and Exchange Commission and
Other Interested Parties

It is my pleasure to transmit this report covering the activities of the Public Oversight Board and the SEC Practice Section for the period ended June 30, 1982.

Significant events have occurred since the issuance of our last report. All charter members of the section have now undergone a peer review. During the 1981-82 year, peer review procedures were further sharpened as a result of additional experience, the use of quality control review panels in connection with certain peer reviews has been eliminated, and SEC staff representatives have expressed satisfaction with the peer review process. The special investigations committee is now operative. In addition, close attention has been given to the matter of increasing membership of the section.

These activities provide continuing assurance of the profession's strong commitment to self-regulation and the continued maintenance of the high standards of the profession.

The Board strongly believes that all firms auditing public companies should join the section. We urge the section to continue its efforts to retain and increase membership and to make users of the services of accountants better acquainted with the section's program.

In the four years since the establishment of the section, the major elements of its program have been established and placed in operation. The Board believes that the accounting profession has given evidence of the merit and viability of self-regulation.

Very truly yours,



John J. McCloy
Chairman

HIGHLIGHTS

INTRODUCTION

- In prior years, the Board issued its report as of March 31. The earlier date was selected primarily because the Securities and Exchange Commission had been issuing a special report to Congress each July 1 on the accounting profession. Since the SEC is no longer issuing such report, the March 31 date is no longer relevant, and the June 30 date permits a more complete reporting on the prior year's peer reviews.

PEER REVIEW COMMITTEE

- Although resignations, terminations, and mergers reduced the number of peer reviews expected to be performed in 1981, 204 reviews were conducted during the year, exceeding by far the number of reviews conducted in any of the three initial years.
- Since March 31, 1981, the committee has asked 17 firms, including two that received unqualified peer review reports with lengthy letters of comments, to provide early assurance that appropriate corrective action is being taken. Ten of these firms have agreed to submit to another review earlier than normally would be required. Others have agreed to a return visit by the reviewers to determine if the deficiencies had been corrected.
- This informal process gives the section the ability to act promptly on matters that do not warrant formal sanction. The Board favors procedures that assure that corrective measures are taken promptly. The formal sanction process remains available for more serious deficiencies where corrective measures satisfactory to the committee are not undertaken or where a firm chooses not to cooperate with the committee.
- Procedures are now in place within the section requiring peer reviewers to report substandard audit engagements to the committee and the corrective action to be taken. In 1981, the committee was informed by reviewers that eight engagements had not been performed in all material respects in accordance with generally accepted auditing standards. Generally, the firms immediately performed procedures

to satisfy themselves that the financial statements were prepared in accordance with generally accepted accounting principles unless the audit of the succeeding year's financial statements was imminent.

- The SEC staff has substantially completed its inspection of selected workpapers of primary reviewers and the Board's workpapers. SEC staff representatives have indicated their satisfaction with the adequacy of review standards, the performance of peer reviews and the effectiveness of the monitoring of the peer review process.
- Based on a study in 1981 to evaluate the cost effectiveness of the quality control review panel in the peer review program during 1978, 1979, and 1980, the Board recommended that the panel be eliminated. The Chief Accountant of the SEC has indicated to the Board that he would support the decision of the section to eliminate the panel because he believes that the benefits to the process attributable to the panel's actions do not exceed its cost. The section's peer review and executive committees have accepted and implemented the Board's recommendation.
- Peer review findings may be indicative of matters that should be addressed or clarified in new or revised professional pronouncements. Representatives of the committee meet periodically with representatives of the auditing standards board to discuss peer review findings.

SPECIAL INVESTIGATIONS COMMITTEE

- To date, 34 cases have been reported to the committee by member firms. Of these, 13 were closed after evaluation of the relative merit of the allegations and the level of public interest. Open cases consist of eight that are being screened, ten that are being monitored and three that are being investigated.
- With respect to the investigations of the three member firms, each decision to investigate was made only after extensive monitoring of developments. Each of the firms was asked to provide additional information needed by the committee to properly discharge its responsibilities. These investigations are in process as of the date of this report.

MEMBERSHIP IN THE SECTION

- The executive committee made several changes in membership requirements based upon recommendations of a specially appointed task force to study all membership requirements.
- The task force on membership requirements recommended and the executive committee amended the requirements to eliminate the annual reporting of (a) the names of the firm's SEC clients, (b) the number of SEC clients whose fees exceed five percent of total domestic firm fees, and (c) a description or chart of the firm's organizational structure.
- The period for partner rotation on audits of SEC clients was extended from five years to seven years for all firms and the requirement was waived for firms with fewer than five SEC audit clients and fewer than ten partners.
- The Board concurs with the changes made since it is convinced that the public interest would be best served when virtually all firms that audit SEC clients are members of the section and this change may help in achieving that goal. However, the Board urges each firm that does not rotate partners on SEC audits to build compensating safeguards into its quality control system.
- Membership in the SEC practice section was 428 firms at June 30, 1982, as compared with 515 firms at March 31, 1981. The attrition is primarily in the category of firms with no SEC clients.
- Members of the section audit all but five of the U.S. companies listed on the New York Stock Exchange and all but 37 of the U.S. companies listed on the American Stock Exchange.
- The Board has decided to defer publication of a list of firms that have "passed" the section's peer review program with the intention of reconsidering the question should the divisional directory not achieve its intended results.

CONCLUSIONS

- The Board believes the self-regulatory structure is sound and is functioning properly.
- We commend the profession for making this unique program of self-regulation operative and the member firms for their commitment to the highest standards of the profession.

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This report of the Public Oversight Board of the SEC Practice Section of the Division for CPA Firms of the American Institute of Certified Public Accountants covers its activities for the period April 1, 1981, through June 30, 1982. In prior years, the Board issued its report as of March 31. The earlier date was selected primarily because the Securities and Exchange Commission had been issuing a special report to Congress each July 1 on the accounting profession. Since the SEC is no longer issuing such report, the March 31 date is no longer relevant, and the June 30 date permits a more complete reporting on the prior year's peer reviews.

I. PUBLIC OVERSIGHT BOARD

A. Responsibilities of the Board

The Board's primary responsibilities are to (1) monitor the performance of the section's peer review, special investigations, and executive committees; (2) determine whether the peer review committee is taking the necessary steps to ensure appropriate action by member firms as a result of peer reviews; (3) make recommendations for improvement in the operation of the section; and (4) report to member firms and the public with respect to its activities.

Principal attention during 1981-82 was devoted to recommending several major improvements in the program and to consulting with the Securities and Exchange Commission and the various committees of the section.

The Board is not a regulatory body; its function is to oversee, encourage, and assist the several components of the self-regulatory program of the accounting profession. The Board makes an independent and objective assessment of, and reports on, the policies and practices of the SEC practice section. The Board is dedicated to the principle of self-regulation. In the formative stages of the program, consideration was given to whether the Board should have line authority, at least in some aspects.

Assumption of line authority and responsibility, however, would violate the accounting profession's self-regulatory program. In addition, if the Board had line authority, it might not be as objective in assessing the effectiveness of the program. As stated in its initial report, the Board--

"... should not have line or appellate review authority. While there may be some advantages to being able to exercise line authority, the Board concluded that its ability to offer objective comment and criticism would be greater if it were not a formal part of the structure for planning and executing policy decisions of the Section. The Board also concluded that its ability to comment publicly on any matter regarding the accounting profession would provide sufficient power to discharge the Board's responsibilities."

Since the Board has the right, and Board members and members of its staff have exercised the right, to attend any and all meetings of the section, the Board is fully apprised of the section's activities. Experience indicates that the Board need not have line authority to be effective and that the section is indeed responsive to the Board's recommendations.

B. Composition of the Board and Staff

William L. Cary and Robert K. Mautz were appointed for additional three-year terms to expire on December 31, 1984. John J. McCloy continues to serve as chairman, John D. Harper and Arthur M. Wood, as Board members, and Richard A. Stark, as legal counsel and Board secretary.

There were no changes in the staff during the year. The staff consists of four CPAs and two secretaries. Occasionally, the Board employs part-time retired professionals to assist its staff in monitoring peer reviews.

Additional details are shown in Exhibit A.

C. Expenses of the Board

Expenses of the Board and its staff are paid from dues paid by the section's member firms. The expenses for the years ended June 30, 1981, and June 30, 1982, were \$691,300 and \$758,400. Detailed statements are shown in Exhibit B.

D. Meetings and Other Activities

The Board monitors the day-to-day activities of the section in a variety of ways. A staff member attends each meeting of the major committees of the section and reports in detail to the Board at its regularly scheduled monthly meetings.

Board members attended selected meetings: meetings of the executive and special investigations committees, conferences where committee members discussed alleged audit failures with the auditing firm involved, conferences where peer reviewers reported their findings to management of the reviewed firm, conferences with members of the SEC and members of the section, special briefing sessions with members of its own staff, and joint meetings with the section's planning committee.

II. EXECUTIVE COMMITTEE

The executive committee consists of representatives of 21 member firms. Currently, 14 firms are entitled to automatic representation on the committee under a provision of the section's organizational document that states that the "committee shall at all times include representatives of all member firms which audit the financial statements of 30 or more registrants under Section 12 of The Securities and Exchange Act of 1934."

Ray J. Groves, the chairman and chief executive of Ernst & Whinney, was reelected as chairman of the committee for 1981-82. In October 1981, representatives of two firms not entitled to automatic representation who had served for three years were replaced by representatives of firms that had not previously been elected to the committee. Three additional changes will become effective in October 1982. Firms represented on the committee are shown in Exhibit C.

III. PEER REVIEW COMMITTEE

A. Responsibilities of the Committee

One of the key membership requirements of the section is that at least once every three years each member firm undergo a review of the quality control system for its accounting and auditing practice. The peer review committee has the responsibility for conducting and administering this program. The committee consists of fifteen individuals from member firms appointed by the executive committee. See Exhibit D.

From inception of the program to date, the committee has processed the reports of over 360 firms that have undergone peer review and placed these reports in the public file. Most reports are accompanied by a letter of comments and the reviewed firm's response indicating the corrective actions taken or to be taken or reasons for not doing so.

The committee can recommend that sanctions be imposed on a firm failing to take appropriate action. In only one instance has a firm failed to take corrective action, choosing to resign rather than demonstrate compliance by undergoing an accelerated peer review. The public file includes appropriate information about the circumstances of this resignation. In several other instances, the committee requested details about planned corrective actions, in addition to those specified in the firm's response, and required the firm to permit a revisit by the reviewers to ascertain whether corrective action had been implemented.

B. Peer Review Results

1. Summary of Firms Reviewed

Although resignations, terminations, and mergers reduced the number of reviews expected to be performed in 1981, 204 reviews were conducted during the year, exceeding by far the number of reviews conducted in any of the three initial years. An analysis by type of review, number of SEC clients, and scope of Board oversight is shown in Exhibit E.

The committee has completed processing 171 reports on 1981 reviews. The "field work" for all remaining 1981 reviews has been completed, but the reports have not yet been submitted by the firms to the committee.

As in prior years, most firms reviewed in 1981 received an unqualified report and an accompanying letter of comments. One of the reviews performed in 1981 was a review of a firm that had received an adverse report on its 1979 review. The firm received an unqualified report on its 1981 review. Exhibit F summarizes the types of reports issued during the first four years of the program.

2. Excluded Engagements

The Board continues to evaluate the reasons given by firms requesting that certain engagements be excluded from the scope of the review. Only four of the 204 firms reviewed in 1981 requested exclusion of a total of five engagements. Under the section's rules, all engagements so

excluded are permitted if litigation is in process or when the client will not permit access to the audit workpapers. None of the exclusions caused the scope of the review to be impaired.

This information has been reported by the Board annually, since some critics thought that many firms would not make workpapers of audit engagements available for review. Since experience has proven otherwise, the Board will not report on this matter in future years unless the number of exclusions increases significantly. *

C. Major Changes in Peer Review Program

Since our last report, the committee has revised and refined the standards developed during the earlier years of the process.

1. Voluntary Corrective Actions

The committee processed and placed in the public file several adverse and highly modified peer review reports. In such cases, the committee requested the firms to demonstrate their commitment to taking corrective action prior to the next triennial review. Actions requested by the committee and agreed to by the firms include--

- submission of revised quality control policies and procedures that correct deficiencies identified during the review,
- a return visit by a reviewer to evaluate actions taken concerning:
 - quality control policies and procedures that were not sufficiently comprehensive or were not complied with,
 - an audit engagement that was deemed not to have been performed in accordance with generally accepted auditing standards,
 - audit engagements supervised by selected individuals,
- a full scope peer review to be conducted generally within one year.

Since March 31, 1981, the committee has asked 17 firms, including two that received unqualified reports with lengthy letters of comments, to provide early assurance that appropriate corrective action is being taken. Ten of these firms have agreed to submit to another review earlier

than normally would be required. Others have agreed to a return visit by the reviewers to determine if the deficiencies had been corrected. The majority of the revisits and accelerated reviews are scheduled to occur after June 30, 1982, thus allowing the firms sufficient time to implement proposed corrective action. Such voluntary compliance achieves the same result as might result from the imposition of a sanction.

This informal process gives the section the ability to act promptly on matters that do not warrant formal sanction. The Board favors procedures that assure that corrective measures are taken promptly. The formal sanction process remains available for more serious deficiencies where corrective measures satisfactory to the committee are not undertaken or where a firm chooses not to cooperate with the committee.

2. Mandatory Reporting of Engagements Not Performed in Accordance With Professional Standards

Occasionally, during the review of accounting and auditing engagements, reviewers will conclude that (1) financial statements issued were not in all material respects in accordance with generally accepted accounting principles or (2) noncompliance with generally accepted auditing standards was so great that the firm did not have a proper basis for issuing its report.

a. Non-GAAP Financial Statements

In 1981, the committee strictly enforced the requirement that the reviewer determine whether the financial statements on each reviewed engagement were presented in all material respects in accordance with generally accepted accounting principles.

During 1981, peer reviewers reviewed the financial statements, reports, and workpapers on 1,206 audit engagements. In only 15 of these did the reviewers conclude that the financial statements were not prepared in all material respects in accordance with generally accepted accounting principles. In eight of these cases, including those of two SEC registrants, the reviewed firm recalled its report and the statements were reissued. In the remaining cases the firms were in the process of performing the subsequent audit and indicated that appropriate corrections would be made. It is to the credit of member firms that corrective actions are being taken in every case. The Board believes this is effective evidence that the peer review process is working in the public's and the profession's best interests.

The section did not have in place procedures to deal with a member firm refusing to withdraw its report on financial statements that, in the opinion of the reviewers, were not in accordance with generally accepted accounting principles. The Board, in a letter dated April 1, 1981, called this matter to the attention of the executive committee:

"We recognize that current professional literature leaves to the auditor who issued the report the final judgement as to whether a report is to be withdrawn. The Board feels that the ability of the firm to make a unilateral decision in such a case might run counter to the essence of a self-regulatory system of which the peer review is a part. It seems quite doubtful that the public interest is being served if a member firm is judged by peers to have erroneously concurred in the recording and reporting by the client of a transaction that is not in accordance with generally accepted accounting principles, and the error is permitted to go uncorrected. This would certainly appear to be so if the firm does not have compelling reasons for failure to act."

In response, the executive committee appointed a task force to recommend what should be done when a member firm does not take appropriate action. As a result, the standards were amended to provide that when the peer review committee and a member firm fail to reach agreement on what action should be taken with respect to an inappropriate report, the firm must agree to have the matter referred to the professional ethics division for resolution and to report the ethics findings to the committee.

While the Board would have preferred that the matter be resolved solely within the section, it did not object to referral of the matter to the professional ethics division. However, the Board asked that the subject be reconsidered soon after the new procedure is first tested.

b. Non-GAAS Audits

Existing professional literature does not deal with the question of what an auditor should do when he subsequently learns that he has not performed sufficient auditing to have issued an opinion. Accordingly, the Board, in a letter to the section's executive committee,

urged that this matter be addressed by the section and further that the matter be referred to the auditing standards board for action. The auditing standards board has the matter on its agenda and the Board is closely following the progress of this project.

Procedures are now in place within the section requiring peer reviewers to report substandard audit engagements to the committee and the corrective action to be taken. In 1981, the committee was informed by reviewers that eight engagements had not been performed in all material respects in accordance with generally accepted auditing standards. Generally, the firms immediately performed procedures to satisfy themselves that the financial statements were prepared in accordance with generally accepted accounting principles unless the audit of the succeeding year's financial statements was imminent. In three cases, the firm's independence appeared to be impaired. All three were properly dealt with: one firm eliminated the source of impairment, another obtained an appropriate waiver from the SEC and so informed the committee, and the third, at the urging of the committee, agreed to refer the matter to the ethics division and to abide by, and report to the committee, the ruling made by the division.

3. Improvement in Peer Review Procedures

In July 1981, with participation by the Board's staff, the committee took several actions to reduce unevenness in peer reviewers' performance and reporting. Letters of comments suggested recommendations for improving the quality control system but often failed to report the underlying peer review findings upon which such recommendations were based; reviewers are now required to report both findings and recommendations. Similarly, the reviewers' summary review memorandum has been expanded to facilitate consideration by the committee of the appropriateness of the report and the letter of comments.

The quality of reviewers' workpaper documentation has been a concern since the program's inception. Significant improvement has resulted from the requirement adopted by the committee in 1981 that a form entitled "Matters for Further Consideration" be used to document matters that indicate significant deficiencies in or compliance with the firm's quality control policies and procedures.

4. SEC Inspection of Reviewers' Workpapers

As previously reported, an agreement was reached in 1980 permitting the SEC staff to inspect certain peer review workpapers of firms that audit one or more SEC

clients; however, workpapers relating to audit engagements are not made available to the SEC staff. The SEC staff makes a random selection of workpapers it is to inspect. Upon completion of the inspection process, the Board reviews the procedures used by the SEC staff to assure that the selections were randomly made. In addition, as in prior years, the SEC staff has access to the Board's oversight workpapers on all peer reviews.

The SEC staff has substantially completed its inspection of selected workpapers of primary reviewers and the Board's workpapers. SEC staff representatives have indicated their satisfaction with the adequacy of peer review standards, the performance of peer reviews, and the effectiveness of the monitoring of the peer review process.

The Board understands the SEC's desire to have a basis for making its own objective evaluation of the adequacy of the peer review program. It is hoped, however, that after this initial period, the SEC will rely solely on inspection of the Board's workpapers for the oversight of the program.

D. Role of the Quality Control Review Panel

The Board conducted a study in 1981 to evaluate the cost effectiveness of the quality control review panel in the peer review program during 1978, 1979, and 1980.

1. Background Information

During the initial stages of the peer review program, the SEC insisted on additional procedures for firm-on-firm reviews. Thus, the section required that a panel be appointed for each firm-on-firm review to issue a separate report on the quality control system of the reviewed firm. When the peer review committee approved administration of peer reviews by associations of CPA firms, it also required that a panel be appointed for each such review. The procedures and the report of the panel largely duplicate those of the reviewer.

2. The Questionnaire Study

Panels were appointed for 88 firm-on-firm and association-administered reviews during 1978, 1979, and 1980. The majority of firms complained about the added expense and the Board decided to determine whether the panel was necessary and cost effective. Questionnaires to elicit information relevant to the effectiveness of panel participation were sent to panel chairmen, engagement review partners, and managing partners of the reviewed firm on each of the 88 reviews in which a panel was involved.

The questionnaires related specifically to the panel's effect (1) on the scope of the review and composition of the review team, (2) on the reporting of the review findings, and (3) in resolving differences between reviewers and the reviewed firm. Generally, parallel questions were asked of engagement partners and panel chairmen to permit comparison of the views of the participants on the same peer review engagements.

Results indicate that, in general, panel participation is contributing little that is not already provided by the oversight of the peer review committee, the staff of the AICPA, and the staff of the Board. Very few panels caused a change in the composition of the review team, scope of the review, or type of report issued. The primary contribution of the panels has been consultation with the engagement partner on how findings should be set forth in the letter of comments.

3. Cost of Panel Involvement

The Board's study revealed that the cost of panel involvement is significant both in terms of dollar amount and in relation to the direct charges of the primary reviewer. As might be expected, the cost of the panel as a percentage of the cost of the primary reviewer was found to increase as the size of the firm decreases, ranging from a low of 3 percent to a high of 81 percent, with half the firms paying 20 percent or more. Additional details are shown in Exhibit G.

In addition to direct panel time and expense charges, peer review cost was increased by the time spent by the primary reviewers (and charged to the reviewed firm) in responding to questions of, and consulting with, the panel. This additional time generally ranged between 1 percent and 5 percent of total reviewers' time.

4. General Conclusions and Recommendations

The survey responses are consistent with the impressions gained by the Board in monitoring the peer review program since its inception. The principal contribution made by some panels was assisting the reviewer in evaluating and reporting the results of the review. Accordingly, the Board recommended that the panel be eliminated. However, for a time, it appears desirable that a preissuance review of the scope of the review and of the report and attendant letter of comments be retained as part of the peer review process, at least until the majority of reviewers gain additional experience with the program. In the Board's view, this preissuance review can be performed effectively by either an independent reviewer or by a member of the peer review committee.

Not every review need be subjected to a preissuance review. The Board concludes that the assignment of a panel solely on the basis of the type of reviewer is inappropriate and, thus, concludes that a preissuance review need not be performed on each firm-on-firm and association-administered review. Furthermore, the reviewers' and the committee's experience over the past four years, together with the effective oversight program of the Board, permits the committee to require that preissuance reviews be performed on a relatively low number of reviews.

The Chief Accountant of the SEC has indicated to the Board that he would support the decision of the section to eliminate the panel because he believes that the benefits to the process attributable to the panel's actions do not exceed its cost. The section's peer review and executive committees have accepted and implemented the Board's recommendation.

E. Changes in Administration of Program

1. Elimination of PCPS Administered Reviews

During the year the executive committee of the section, in conjunction with its counterpart of the private companies practice section, discontinued PCPS administration of reviews of firms that are members of both sections, as recommended by the Board in its 1980-81 report. The practice, originated at the request of some firms that belonged to both sections and on the assumption that the private companies practice section would assign reviewers more familiar with their quality control system, caused significant delays in processing peer review reports. In terminating the arrangement, the executive committees noted that both sections assign reviewers from firms similar in size and complexity to that of the reviewed firms.

2. Information in the Public File

Annual reports of member firms, detailing size and other characteristics of the practice, are placed in the section's files available to the public. Peer review findings and inquiries initiated or actions taken by the committee regarding each member firm are also placed in the public file, as well as information about the termination of a peer review, if applicable.

An important change adopted by the committee at the Board's suggestion is a requirement that the public file of a resigned member be retained for three years and that the file include details on the circumstances of withdrawal. The change was precipitated by actions taken

by two firms following their peer reviews. One firm resigned rather than submit its peer review report and letter of comments to the committee for processing, and another resigned rather than submit to an accelerated peer review.

3. Timely Processing of Peer Reviews

The committee, disappointed at the pace at which some reviews are processed, adopted new procedures intended to accelerate the completion of peer reviews. Vigorous enforcement of the new deadlines for reviewers should greatly improve the process in future years.

In addition, the Board suggests that member firms be urged to have their reviews conducted during the summer and fall months.

4. Training Course for Reviewers

The section (together with PCPS) annually conducts peer reviewer training programs for individuals desiring to conduct peer reviews. The 1982 programs prepared by and presented in conjunction with the AICPA continuing professional education division used excellent course materials and were effectively presented. These programs were subsidized equally by both sections, since tuition from enrollments was not sufficient to cover all costs.

The Board's staff joined the staff of instructors at three of the 1981 training sites and also met with representatives of the CPE division to offer suggestions for improving the program in 1982.

F. Board Monitoring of Peer Reviews

1. Board Staff Oversight Procedures

In spite of the significant increase in the number of reviews in 1981, the Board continued its policy of monitoring each review and of visiting all firms with five or more SEC clients during the course of the review. Details are shown in Exhibit E.

The use of the report review program, which consists of a review of reports and selected peer review workpapers, was increased for firms with no SEC clients during 1981. This program now requires review of the summary review memorandum and the resolution of matters where the reviewers concluded that performance on an engagement did not comply with professional standards.

2. Questions Raised by Staff on Specific Reviews

Generally, peer reviews are being performed with a high degree of compliance with the standards. However, the Board's staff brought to the committee's attention several reviews that seemed not to have been performed in accordance with the standards. Most questions related to incomplete or unclear documentation of peer review findings involving newly adopted requirements for preparation of the summary review memorandum and use of the "Matter for Further Consideration" form. All questions were resolved to the satisfaction of the committee and the staff.

The staff again noted unevenness in reporting of similar peer review findings by different reviewers. In a few instances, the difficulty experienced by reviewers in making reporting decisions (modified versus unqualified, adverse versus modified) suggests that reviewers would benefit from further guidance. In cases where issuance of an unqualified or a modified report became judgmental, the letter of comments adequately described the deficiencies and the committee confirmed that the reviewed firm took appropriate follow-up action. The committee, with Board staff participation, continues to seek and evaluate solutions intended to produce more uniform reporting.

3. Matters Referred to Auditing Standards Board for Consideration

Peer review findings may be indicative of matters that should be addressed or clarified in new or revised professional pronouncements. Representatives of the committee meet periodically with representatives of the auditing standards board to discuss peer review findings. Foremost among the problems encountered by peer reviewers is the absence of comprehensive audit workpaper documentation, making it difficult for reviewers to conclude that performance was in accordance with generally accepted auditing standards. In April 1982, the auditing standards board issued a statement that revises existing literature.

IV. SPECIAL INVESTIGATIONS COMMITTEE

A. Responsibilities of the Committee

The special investigations committee considers whether allegations of audit failures with respect to SEC clients of member firms indicate the need for corrective measures by such firms, for changes in professional standards, and/or for appropriate disciplinary measures.

Member firms must report litigation against them or their personnel, or a proceeding or investigation publicly announced by a regulatory agency that involves clients or former clients that are or were SEC registrants and that allege deficiencies in the conduct of an audit or in reporting thereon in connection with any required filing under the federal securities law. The committee screens this and other information available and decides whether to (1) monitor further developments, (2) conduct an investigation of the firm's quality control policies and procedures or review other engagements performed by the personnel involved or other engagements in the same industry as the reported case (not an investigation of the specific alleged audit failure), (3) request authority from the executive committee to investigate the specific alleged audit failure, or (4) close its files on the case.

The objectives of an investigation of the firm or the specific alleged audit failure are to determine whether--

- the firm's quality controls are adequate, or
- there has been a material departure from generally accepted auditing standards or a material failure to comply with quality control standards, or
- there is a need for reconsidering the adequacy of certain generally accepted auditing standards or quality control standards.

A member firm is required to furnish information to the committee concerning an investigation unless the firm can demonstrate (a) that there is a likelihood that the firm's interests in pending litigation or other proceeding or investigation will be unduly prejudiced by providing the requested information and (b) that the committee's need for such information is not sufficient to override the interest of the firm or individuals in avoiding prejudice in such litigation or other proceeding or investigation. Failure to cooperate may be a basis for the imposition of sanctions.

B. Major Developments

1. Guidelines Adopted by the Committee

The committee developed internal guidelines to be applied in reviewing and forming consistent conclusions on actions to take concerning reported litigation. The guidelines provide a framework for considering the merits

of the litigation, extent of public interest, and implications for current professional standards.

The Board and its staff reviewed and commented on the guidelines used by the committee in its decision-making process and believe that such criteria are logical, provide consistency, and are being objectively applied. A task force is considering possible revision of the guidelines so as to expedite and improve its decision-making, recognizing that they are merely a set of guidelines and not a set of rules that must be rigidly followed. These include review of findings of prior peer reviews and, in certain circumstances, results of procedures performed by peer reviewers at the request of the committee.

2. Investigations Begun and Other Procedures Used

The committee has thus far initiated investigations of three member firms. In each situation the decision to investigate was made only after extensive monitoring of developments. Each of the firms was asked to provide additional information needed by the committee to properly discharge its responsibilities. These investigations are in process as of the date of this report. These actions demonstrate the committee's commitment to serving the public interest and, at the same time, its unwillingness to act precipitately.

The committee, with the cooperation of firms reporting litigation, has reviewed certain workpapers relating to several specific alleged audit failures. Because such actions were voluntarily agreed to--and in one case suggested by the firm involved--it was not necessary to obtain the executive committee's authorization to investigate these cases. Procedures used included among other things--

- making inquiries concerning the office and personnel performing the engagement in question,
- reviewing engagement workpapers of the specific alleged audit failure, subsequent to the conclusion of the litigation, and discussing the audit with the engagement partner, and
- reviewing a special report to an audit committee prepared by the firm documenting in detail the nature of the issues involved in the litigation.

3. Interaction With AICPA Standard-Setting Boards and Committees

A major objective of the committee is to determine whether alleged audit failures raise questions about the adequacy of professional standards. In meeting that objective, the committee expressed to the auditing standards board its view that an exposure draft of an audit guide on the banking industry should include additional guidance on the implementation of certain accounting principles. The chairman of the auditing standards board has indicated that he will act on that recommendation. In addition, the committee advised both the auditing standards board and the accounting standards executive committee that the economic environment presently affecting banks and other factors support reconsideration of the accounting standards for investment account securities of banks. The matter has been referred to the banking committee. It should be noted, however, that the AICPA can only encourage standards-setters and regulators to undertake such a reconsideration, since the AICPA has no authority to establish enforceable accounting standards.

4. Status of Reported Cases

To date, 34 cases have been reported to the committee by member firms. Of these, 13 were closed after evaluation of the relative merit of the allegations and the level of public interest. The Board concurs with the committee's decision to close each of these cases. In each case, the firm had received an unqualified peer review report, professional literature in the areas affected by the litigation appeared adequate, and the case did not seem to have significant public interest.

Open cases consist of eight that are being screened, ten that are being monitored, and three that are being investigated.

C. Administration of Program

1. Composition of the Committee

The committee is appointed by the executive committee and consists of nine members. The present composition of the committee and firm affiliations of the members are set forth in Exhibit D.

In September 1981, the executive committee appointed Robert A. Mellin, a partner in Hood & Strong, as chairman. Mr. Mellin replaced Rholan E. Larson, a partner in Larson, Allen, Weishair & Co. upon Mr. Larson's election as vice-chairman of the AICPA.

2. Coordination with Ethics Division

In 1980, the committee and the AICPA professional ethics division's executive committee prepared a joint memorandum setting forth policies and procedures to coordinate their activities to preclude concurrent investigations. The ethics division now refers to the committee any case involving an SEC client of a member firm. To date, four such referrals have been received. After the committee closes its files on a case, the file is available to the ethics division.

D. Board Oversight of Committee Activities

Since the Board's last report, the committee has held seven meetings and members assigned to cases under investigation have held several meetings with personnel of the firms involved. One or more Board members attended three meetings; members of the Board's staff attend each meeting.

The Board actively monitors the committee's decisions on individual cases. The staff reads the pertinent court documents, financial information, and correspondence related to cases reported and attends meetings between firm representatives and committee members.

V. SECTION MEMBERSHIP

A. Changes in Membership Requirements

The executive committee made several changes in membership requirements based upon recommendations of a specially appointed task force to study all membership requirements. Other changes made were in response to initiatives taken by the SEC.

1. Changes in Reporting of MAS Engagements

On August 21, 1981, the SEC proposed to, and subsequently did, rescind Accounting Series Release no. 250, which required proxy statement disclosure of non-audit services provided by the auditor and the relationship of fees for such non-audit services to fees for audit services.

In support of the proposed rescission, the executive committee amended the membership requirements to require annual reporting of additional information with respect to fees for management advisory services performed for SEC audit clients. See Exhibit H. The Board agrees

with the changes made in membership reporting requirements regarding MAS engagements and intends to monitor such data and report any trends that, in its opinion, are not in the public interest.

It should be noted, that during the course of peer reviews, the reviewers test whether the firm's role in providing management advisory services impairs the firm's independence.

2. Other Changes in Membership Reporting Requirements

Primarily in response to concerns expressed by smaller firms, the task force on membership requirements recommended and the executive committee amended the requirements to eliminate the annual reporting of (a) the names of the firm's SEC clients, (b) the number of SEC clients whose fees exceed five percent of total domestic firm fees, and (c) a description or chart of the firm's organizational structure. However, this information continues to be made available to peer reviewers. The Board concurs with the decision to eliminate such data from the public file.

3. Rotation of Engagement Partner on SEC Audits

One of the primary objectives of the task force on membership requirements was "to make membership in the section more attractive to nonmembers and members alike by modifying or identifying those membership requirements that are no longer deemed to be appropriate in the circumstances while maintaining an effective self-regulatory program" (Emphasis added). The task force based its recommendations primarily on the results of a survey of nonmember firms, the views of the Board and the private companies practice section, and the results to date of the peer review program. Analysis and discussion led the task force to conclude that the requirement for mandatory rotation of audit partners on SEC engagements every five years was unduly burdensome, particularly for smaller firms. As a result, the period for partner rotation on audits of SEC clients was extended from five years to seven years for all firms and the requirement was waived for firms with fewer than five SEC audit clients and fewer than ten partners.

The Board believes that rotation of partners on SEC audit engagements is an appropriate membership requirement with which all firms should comply, if at all possible. It recognizes, however, that smaller firms may find it difficult if not impossible to comply with this requirement. Therefore, the Board concurs with the changes made since it is convinced that the public interest would

be best served when virtually all firms that audit SEC clients are members of the section and this change may help in achieving that goal. However, the Board urges each firm that does not rotate partners on SEC audits to build compensating safeguards into its quality control system. For example, an independent preissuance review becomes more significant for a firm that does not periodically rotate partners. Such a firm should consider using a rather broad scope of review, including review of selected key area audit workpapers to assure that the engagement was performed in accordance with professional standards.

B. Membership in the Section

Membership in the SEC practice section, as well as membership in the private companies practice section, is declining.

1. Analysis of Member Firms

Membership in the SEC practice section was 428 firms at June 30, 1982, as compared with 515 firms at March 31, 1981. The attrition is primarily in the category of firms with no SEC clients. Over the past year, membership of firms with SEC clients decreased only slightly, from 225 to 205 (including a reduction of five firms due to mergers), but the number of SEC clients audited by member firms increased from 8,952 at March 31, 1981, to 9,618 at June 30, 1982.

Over 1,450 firms belong only to the private companies practice section. Differences in membership requirements between the two sections apply mainly to SEC clients. While the Board has no responsibility with respect to overseeing the activities of that section, the Board notes with interest that while the number of PCPS-only member firms decreased from 1,602 at March 31, 1981, to 1,454 at June 30, 1982, the number of PCPS-only firms with SEC clients increased from 107 to 116. Details are shown in Exhibit I.

2. Analysis of Firms Auditing SEC Clients

The most recent edition of Who Audits America¹ lists approximately 1,050 domestic firms that audit

¹ 7th ed. (Menlo Park, Calif: Data Financial Press, October 1981).

publicly traded companies.² Two hundred and ninety-eight of these firms are members of the division (187 in the SEC practice section and 111 in only the private companies practice section). However, the ratio of member firms to nonmember firms standing alone does not give an accurate measure of the assurance and added protection given to the financial and investment communities and the public by member firms of the division. When the data are analyzed by sales volume, the analysis reveals that 98 percent of the sales volume of these companies is audited by members of the division. See Exhibit J. Perhaps even more meaningful are the number and relative size of the SEC clients audited by member firms. Members of the section audit all but five of the U.S. companies listed on the New York Stock Exchange and all but 37 of the U.S. companies listed on the American Stock Exchange.

3. Membership Promotion

While the foregoing statistics are impressive, many smaller firms with a limited number of SEC clients have not responded to the new self-regulatory efforts of the profession. The Board has been working with the section in its efforts to increase its membership. The Board sent letters to almost 800 firms that were not members of the section. See Exhibit K. Although the promotional letters did not request a response, 46 firms wrote to Chairman McCloy explaining their reasons for not joining and in some cases asked for more information or an application to join the section.

Almost universally, each firm that undergoes the required triennial peer review reports that the process improves the quality of its accounting and auditing practice. SEC Chairman John S. R. Shad reported that the "Section's peer review and other requirements inspire investors' confidence in its members' high professional standards and competency."³ Therefore, the section should continue to urge nonmember firms to join.

² A "publicly traded" company as used by Who Audits America is one whose securities are traded, including those traded "over-the-counter." Because many companies listed in the directory do not file an annual report with the SEC, they are not SEC clients as defined for implementing sections IV3(e) and (f) of the section's organizational structure and functions document.

³ Shad, John S. R., Chairman of the Securities and Exchange Commission, in a speech before the AICPA's National Conference on Current SEC Developments, Washington, D.C., January 12, 1982.

4. Directory of Firms

In its 1980-81 report, the Board reported that it would consider publishing in this year's report the names of all firms that have "passed" peer review, based on its view that the general public can and should place reliance on the quality of such firms.

The Board discussed the subject with persons within and outside the profession. While most persons outside the profession favored the publication of such a listing, the majority of responses from persons within the profession said they believed it would not materially increase membership, would be divisive and counter-productive, and would run a grave risk of a renewed effort by some CPAs to abolish the division for CPA firms. The publication by the Board would necessarily have to be limited to those firms that belong to the SEC practice section since it does not oversee the activities of the private companies practice section, which also requires its members to undergo a peer review at least triennially.

The Board notes the AICPA will publish in 1982 a directory of firms belonging to the division without designating section membership. The Board would prefer that the directory show to which section(s) the various members belong and the status of each firm with respect to its peer review. The Board believes that the proposed directory is a satisfactory compromise.

Consequently, the Board has decided to defer publication of a list of firms that have "passed" the section's peer review program with the intention of reconsidering the question should the divisional directory not achieve its intended results.

VI. CONCLUSIONS

There is now considerable evidence that the peer review program is functioning as intended and that section members are taking actions needed to improve the quality of their practices. Reviews demonstrate that section members, although already practicing at high quality levels, are receptive to suggestions to further upgrade their practices. The Board notes that PCPS members also are making a substantial commitment to self-regulation.

Significant progress was made during the year by the special investigations committee. The committee completed the difficult task of formalizing its decision-making so that it can uniformly and objectively determine the level of scrutiny it should give each reported case of alleged or suspected audit failure.

The Board believes the self-regulatory structure is sound and is functioning properly. While the structure for imposing sanctions has yet to be tested, the Board believes the section will be ready to meet that test when circumstances call for such action.

The members of the Board sincerely believe that every firm auditing public companies should join the SEC practice section and that all firms with an accounting and auditing practice should join one or both sections of the division for CPA firms. We commend the profession for making this unique program of self-regulation operative and the member firms for their commitment to the highest standards of the profession. The Board believes strongly in the concept of self-regulation as opposed to federal regulation and reaffirms its commitment to discharge faithfully its oversight role.

SECRET

COMPOSITION OF PUBLIC OVERSIGHT BOARD

<u>Member</u>	<u>Term Expires December 31</u>	<u>Affiliation</u>
John J. McCloy Chairman	1983	Partner, Milbank, Tweed, Hadley & McCloy, New York
William L. Cary	1984	Professor of Law, Columbia University, New York
John D. Harper	1982	Chairman of Communications Satellite Corporation and former chairman and chief executive officer of Aluminum Company of America
Robert K. Mautz	1984	Director of Paton Accounting Center and Professor of Accounting, University of Michigan
Arthur M. Wood	1982	Former chairman and chief executive officer of Sears, Roebuck & Co.

Richard A. Stark	Legal Counsel and Secretary to the Board and Counsel to Mr. McCloy	Partner, Milbank, Tweed, Hadley & McCloy, New York
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Permanent Staff

Louis W. Matusiak	Executive Director
Charles J. Evers	Technical Director
David P. Boxer	Assistant Technical Director
Alan H. Feldman	Assistant Technical Director
Marcia E. Brown	Administrative Assistant
Miriam Freilich	Secretary

Supplemental Staff

Sidney M. Brady	Retired partner of Main Lafrentz & Co.
John W. Hawekotte	Retired partner of Arthur Andersen & Co.
John W. Nicholson	Retired partner of Arthur Young & Company

PUBLIC OVERSIGHT BOARD
STATEMENT OF EXPENSES
FOR THE YEARS ENDING
JUNE 30, 1981 AND JUNE 30, 1982

	<u>Year Ending</u> <u>June 30, 1981</u>	<u>Year Ending</u> <u>June 30, 1982</u>
Regular fees of Board members	\$157,500	\$170,000
Fees for professional services paid to firms of Board members	29,000	38,600
Reimbursement of expenses to Board members and their firms	10,100	9,200
Salaries of staff, including part-time reviewers	337,900	372,300
Other expenses:		
Personnel	59,000 (A)	63,400
Occupancy	32,400	34,300
Staff travel and related expenses	35,000	33,600
Printing and paper	8,700	10,700 (B)
Commercial services	-0-	12,500 (C)
General office expenses	<u>21,700</u>	<u>13,800 (D)</u>
Total other expenses	<u>156,800</u>	<u>168,300</u>
Total expenses	<u>\$691,300</u>	<u>\$758,400</u>

Notes

- (A) Includes \$13,500 of relocation expenses of a new staff member.
- (B) Includes provision for printing 1981-82 annual report (printed in July 1982).
- (C) Fees paid for staff compensation study.
- (D) Major causes of variance from prior year's expenses are: \$5,300 reduction in postage (no annual report mailed during year); \$1,400 reduction in telephone costs; and \$1,000 reduction in Board meeting costs.

SEC PRACTICE SECTION
EXECUTIVE COMMITTEE

<u>Representative</u>	<u>Firm Affiliation</u>
Ray J. Groves, Chairman	*Ernst & Whinney
Peter Arnstein (A)	John F. Forbes & Company
George L. Bernstein	*Laventhol & Horwath
T. Frank Booth	A. M. Pullen* & Company
Ivan O. Bull	*McGladrey, Hendrickson & Co.
Robert M. Coffman	*Fox & Company
J. Michael Cook	*Deloitte Haskins & Sells
Mario J. Formichella	*Arthur Young & Company
W. Donald Georgen	*Touche Ross & Co.
Howard Groveman	*Alexander Grant & Company
William D. Hall	*Arthur Andersen & Co.
Thomas L. Holton	*Peat, Marwick, Mitchell & Co.
Charles Kaiser, Jr. (B)	Pannell Kerr Forster
William B. Keast	*Coopers & Lybrand
Charles E. Keller, III	Stoy, Malone & Company
Bernard Z. Lee	*Seidman & Seidman
J. Curt Mingle (B)	Clifton Gunderson & Co.
Richard W. Paddock	Battelle & Battelle
Howard L. Stone (A)	Altschuler, Melvoin & Glasser
John A. Thompson	*Main Hurdman
Michael A. Walker	Mann Judd Landau
Gary J. Wolfe (A)	Cherry, Bekaert & Holland
John W. Zick	*Price Waterhouse
Donald P. Zima (B)	May Zima & Co.

* Firm entitled to permanent seat because firm audits 30 or more registrants under Section 12 of the Securities Exchange Act of 1934.

(A) Term expires October 1, 1982.

(B) Nominated to serve a term commencing October 1, 1982.

SEC PRACTICE SECTION
PEER REVIEW COMMITTEE

<u>Member</u>	<u>Firm Affiliation</u>
Joseph X. Loftus, Chairman	Price Waterhouse
Kenneth F. Anderson	Arthur Andersen & Co.
John F. Barna	Peat, Marwick, Mitchell & Co.
Clark C. Burritt	A. M. Pullen & Company
Robert S. Campbell	Thorsen, Campbell, Rolando & Lehne
Paul B. Clark, Jr.	Main Hurdman
Robert W. Egner	Coopers & Lybrand
Arthur I. Farber	Altschuler, Melvoin & Glasser
Robert E. Hammond	Ernst & Whinney
Billy E. Hixon	Baird, Kurtz & Dobson
John G. F. Knight	Purvis, Gray and Company
James I. Konkell	Touche Ross & Co.
Daniel J. Moylan	Deloitte Haskins & Sells
Robert H. Temkin	Arthur Young & Company
Jerry E. Whitehorn	Whitehorn, Bradsher & Tankersley

SPECIAL INVESTIGATIONS COMMITTEE

<u>Member</u>	<u>Firm Affiliation</u>
Robert A. Mellin, Chairman	Hood and Strong
Mark J. Feingold	Laventhol & Horwath
*Edwin P. Fisher	Arthur Andersen & Co.
*Thomas B. Hogan	Deloitte Haskins & Sells
Harry L. Laing	A. M. Pullen & Company
*Leroy Layton	Main Hurdman
*John B. O'Hara	Price Waterhouse
*Leon P. Otkiss	Peat, Marwick, Mitchell & Co.
*David Wentworth	McGladrey, Hendrickson & Co.

* Retired

ANALYSIS OF 1981 PEER REVIEWS
BY TYPE OF REVIEW, NUMBER OF SEC CLIENTS,
AND SCOPE OF BOARD OVERSIGHT

<u>Reviewer*</u>	Number of Firms by Number of SEC Clients				<u>Total</u>
	<u>30 or more</u>	<u>5 to 29</u>	<u>1 to 4</u>	<u>None</u>	
Firm-on-firm review	5	2	11	23	41
CART review	-	5	42	78	125
Association review	-	1	13	24	38
Total	<u>5</u>	<u>8</u>	<u>66</u>	<u>125</u>	<u>204</u>
<u>Scope of Board Oversight**</u>					
Visitation and workpaper review	5	8	17	11	41
Workpaper review	-	-	30	14	44
Report review	-	-	19	100	119
Total	<u>5</u>	<u>8</u>	<u>66</u>	<u>125</u>	<u>204</u>

* A peer review may be conducted by a firm (firm-on-firm review), by a committee-appointed review team (CART review), or by a team appointed or authorized by an association of CPA firms (association review).

** The Board selects the scope of oversight for individual reviews by random sampling; however, 100 percent of the reviews of firms having 5 or more SEC clients are subjected to visitation and workpaper review.

SUMMARY OF TYPES OF PEER REVIEW REPORTS
ISSUED DURING FIRST FOUR YEARS OF THE PROGRAM

	Review Year				
	<u>Total</u>	<u>1981</u>	<u>1980</u>	<u>1979</u>	<u>1978</u>
Firms receiving unqualified report without letter of comments	29	16	9	2	2
Firms receiving unqualified report and letter of comments	283	138	109	28	8
Firms receiving modified report(A) (B)	48	15	24	8	1
Firms receiving adverse report(A)	<u>7</u>	<u>2</u>	<u>3</u>	<u>2</u>	<u>-</u>
	<u>367</u>	<u>171(C)</u>	<u>145</u>	<u>40</u>	<u>11</u>

(A) At the peer review committee's request, all seven firms receiving adverse reports and eight firms receiving highly modified reports agreed to undergo another review earlier than would normally be required. Three of the firms have already had a follow-up review, and each received an unqualified report. Reviews of seven of these firms will be conducted in 1982, and the remaining five, in 1983.

(B) Of the 48 modified reports issued, 18 were modified for more than one reason. The frequency of modification by area is as follows:

Inadequate documentation or non-compliance	
in the following areas of quality control:	
Inspection	25
Supervision	20
Independence	3
Advancement	3
Consultation	1
Non-compliance with section membership	
requirements:	
Concurring partner review	9
Liability insurance	5
Continuing professional education	3

(C) Reports of the 33 peer reviews not yet processed by the committee are expected to contain a disproportionate number of modified and adverse reports. The percentage of modified and adverse reports on 1981 reviews, however, is expected to approximate the percentage of such reports issued on 1980 reviews.

COST OF PANEL INVOLVEMENT

RESPONSES OF MANAGING PARTNERS
OF FIRMS UNDERGOING A PEER REVIEW
FOR WHICH A PANEL WAS ASSIGNED
IN 1979, 1980 AND 1981

Size of Firm by Number of Professional Staff	Time and Expense Charges of Primary Reviewer			Percent of Panel Charges to Primary Reviewer Charges		
	Low	High	Mean	Low	High	Mean
1,000 or more	\$189,955	\$1,212,000	\$691,606	3.2%	22.3%	8.7%
200 to 999	33,708	171,228	76,937	8.2	32.1	19.8
100 to 199	16,690	40,335	22,605	12.8	27.3	20.0
50 to 99	9,612	28,000	17,841	7.1	49.1	21.2
30 to 49	5,851	20,580	17,607	10.0	44.8	27.5
20 to 29	3,126	10,839	7,148	14.7	47.3	32.8
11 to 19	1,539	10,172	5,799	12.3	63.7	28.8
10 or under	1,200	11,000	4,220	12.1	80.6	33.4



American Institute of Certified Public Accountants

1211 Avenue of the Americas, New York, New York 10036 (212) 575-6200

October 9, 1981

To the Managing Partners of
SEC Practice Section Member Firms

Dear Colleague:

Change in SECPS Membership Requirements

On August 20, 1981, the Securities and Exchange Commission rescinded Accounting Series Release No. 264 and proposed rescinding ASR 250. Both of those accounting series releases related to nonaudit services provided by CPA firms, and they have been viewed unfavorably by the profession as well as by many SEC registrants. In some cases, they have had a negative economic impact on public accounting firms. The SEC stated that this was unintended.

However, in its proposal to rescind ASR 250, the Commission noted that there is a need to make adequate information available to the public and indicated that it would look to the SEC Practice Section to provide that information. After studying alternatives, the SECPS Executive Committee adopted a new reporting requirement with respect to MAS fees, effective for annual reports filed with the Section that cover years ending on or after January 1, 1982.

The SECPS Executive Committee believes that adoption of the reporting requirement accompanying this letter is necessary to enable the Commission to act favorably on its proposal to rescind ASR 250. The Executive Committee also believes the new reporting requirement is far less burdensome than the requirements of ASR 250.

We are pleased to make this announcement because it is an indication that the SEC Practice Section can have a positive effect in reducing the amount of government regulation affecting firms and their clients. We will continue to work on ways to enhance the value of SECPS membership. Thank you for your support.

Sincerely,

A handwritten signature in cursive script that reads "Ray J. Groves".

Ray J. Groves
Chairman
SECPS Executive Committee

RJG:gs

ANNOUNCEMENT OF NEW SECPS REPORTING REQUIREMENT

At its meeting on September 9, 1981, the Executive Committee of the SEC Practice Section adopted the following addition to the matters to be included in the firm's annual report to the Section pursuant to section IV.3(g) of the organizational structure and functions document of the Section:

Fees for MAS services performed for SEC audit clients, expressed as a percentage of audit fees charged to SEC clients, prepared in the following manner:

<u>Range of MAS Fees to Audit Fees for SEC Audit Clients</u>	<u>Number of SEC Audit Clients</u>
0 - 25%	
26 - 50%	
51 - 100%	
Over 100%	<hr/>
Total number of SEC audit clients	<hr/> <hr/>

The total number of SEC audit clients reported in this summary shall agree with the number reported pursuant to the requirement of section IV.3(g)(8). The firm shall also report how many of the number of SEC audit clients included in the "over 100%" category fell into that category for three consecutive years, including the current year.

This requirement is effective for reports covering fiscal years ending on or after January 1, 1982.

ANALYSIS OF MEMBERSHIP
IN THE DIVISION FOR CPA FIRMS
BY NUMBER OF SEC CLIENTS AND BY SECTION
MARCH 31, 1981 TO JUNE 30, 1982

Number of Firms by Number of SEC Clients	March 31, 1981	New Members	Resignations	Mergers	Terminations	Classification Changes--Net	June 30, 1982
Five or more SEC clients							
Both sections or SECPS only	47	-	(3)	(1)	-	2	45
PCPS only	1	-	-	-	-	-	1
One to four SEC clients							
Both sections or SECPS only	178	11	(28)	(4)	(6)	9	160
PCPS only	106	16	(4)	(2)	-	(1)	115
No SEC clients							
Both sections or SECPS only	290	19	(56)	(1)	(18)	(11)	223
PCPS only	1,495	193	(296)	(25)	(30)	1	1,338
Totals							
Both sections or SECPS only	515	30	(87)	(6)	(24)	-	428
PCPS only	1,602	209	(300)	(27)	(30)	-	1,454
Totals	2,117	239	(387)	(33)	(54)	-	1,882

ANALYSIS OF
FIRMS THAT AUDIT PUBLICLY TRADED COMPANIES
LISTED IN THE SEVENTH EDITION OF WHO AUDITS AMERICA

	<u>SEC Registrants*</u>		<u>Annual Sales*</u> (millions)	
	<u>Number</u>	<u>Percent</u>	<u>Dollar</u>	<u>Percent</u>
Companies with annual sales of \$1 million or more audited by members of the division for CPA firms:				
By the eight largest U.S. firms in the SECPS	6,079	69.5%	\$3,226,956	95.4%
By other SECPS members	1,347	15.4	93,112	2.7
By PCPS-only members	143	1.6	2,028	.1
Companies audited by foreign firms	69	.8	35,957	1.1
Companies whose auditors are not identified**	136	1.6	10,892	.3
Companies audited by U.S. firms not members of the division for CPA firms	<u>973</u>	<u>11.1</u>	<u>12,352</u>	<u>.4</u>
	<u>8,747</u>	<u>100%</u>	<u>\$3,381,297</u>	<u>100%</u>

* Clients with annual sales of less than \$1 million are excluded from this tabulation.

** Many of the companies are banking institutions, which are not "SEC clients" as defined.

Public Oversight Board

SEC PRACTICE SECTION

American Institute of Certified Public Accountants

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October 21, 1981

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Gentlemen:

Over 2,000 firms are members of the AICPA Division for CPA Firms, of which approximately 500 are members of the SEC Practice Section. These 500 firms collectively audit more than 90 percent of the publicly-owned corporations regulated by the SEC.

The critics of your profession's self-regulatory program will not be impressed until all firms that audit SEC registrants display their faith in a sound self-regulation program by becoming members of the SEC Practice Section. Your firm is among those that have not yet joined. To encourage you to do so is the reason for this letter.

Firms report that there are specific measurable benefits from membership in the Division for CPA Firms. Those more frequently cited are:

Preparation for peer review is in itself a desirable exercise in self-discipline, provides substantial benefits, and usually assures a favorable peer review report.

Peer reviews help firms improve the efficiency of their operations, thereby reducing operating costs.

Practitioners who participate in peer reviews absorb new ideas and practices they later install in their own firms.

The favorable report on a firm's quality controls improves a CPA firm's credentials. Distribution of that report is an effective way to combat the displacement problem.

Prospective clients are impressed by membership in an organization that requires compliance with the highest professional standards.

These benefits are obtained from membership in either the Private Companies or SEC Practice Section. However, the SEC Practice Section was specifically established for all firms, regardless of size, that practice before the SEC. The Executive Committee of the Section has been most sensitive to the concerns of smaller firms in setting membership requirements and policies. Examples of this sensitivity include reduced membership dues, reduced liability insurance requirements and other appropriate modifications.

The members of the Public Oversight Board sincerely believe that every firm auditing public companies should join the SEC Practice Section. Therefore, for the best interests of the profession and of your firm, we urge you to consider favorably becoming a member of the SEC Practice Section.

Sincerely,


John J. McCloy
Chairman

JJM/mb