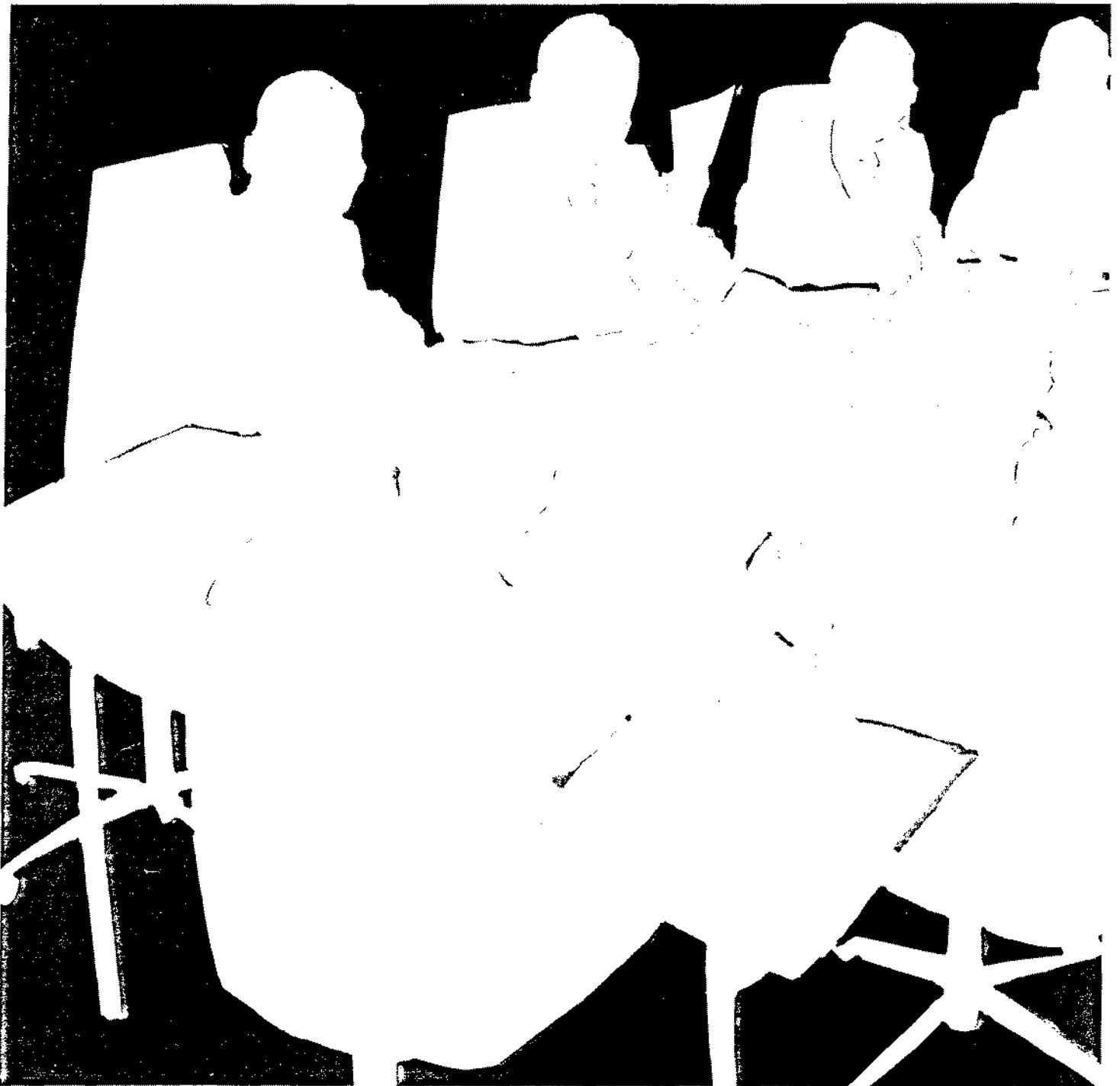


ANNUAL REPORT

1986 1987

PUBLIC OVERSIGHT BOARD



SEC Practice Section

American Institute of Certified Public Accountants

Public Oversight Board

A. A. Sommer, Jr., *Chairman*

Robert K. Mautz, *Vice Chairman*

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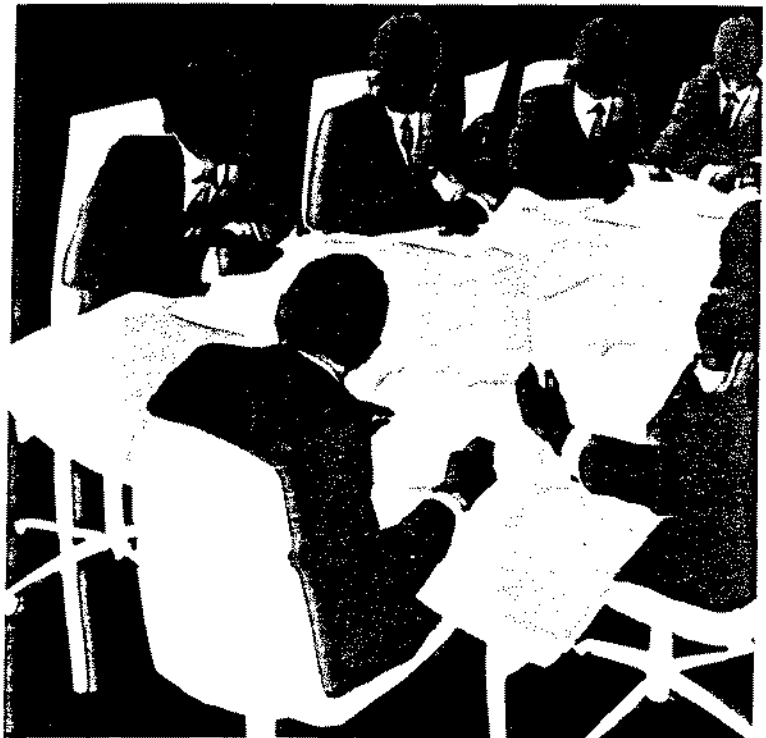
New York, NY 10022

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ANNUAL REPORT
1986-1987

**PUBLIC
OVERSIGHT
BOARD**

*SEC Practice Section
American Institute of Certified Public Accountants*



Foreword

It is my pleasure and honor, on behalf of the Public Oversight Board, to present this ninth report of the Board.

In response to questions and criticisms raised in the course of Congressional hearings, but also in significant measure because of the accounting profession's on-going efforts to maintain and improve the quality of financial reporting, a number of initiatives were undertaken, both by the profession and by others during the past year. The Auditing Standards Board published ten proposals for new or revised standards which, among other things, are intended to narrow the gap between the public's expectations and the profession's standards with respect to the detection of fraud, to involve the auditor to a greater extent in assessing the adequacy of a client's internal controls, and to increase the responsibility of the auditor with respect to the assessment of the likelihood of the client's continued existence. The National Commission on Fraudulent Financial Reporting (the Treadway Commission) published for public comment a draft report containing far-reaching recommendations to assure the heightened integrity of the financial reporting process. The AICPA's Special Committee on Standards of Professional Conduct for Certified Public Accountants (the Anderson Committee) made numerous recommendations intended to assure the long-term relevance and effectiveness of the profession, and the Institute's Council has approved them for balloting by the membership later in 1987.

One recommendation of the Anderson Committee was put to a vote of the membership during the year—a proposal to make membership in the SEC Practice Section (which the Board oversees) mandatory for firms auditing SEC registrants if their partners were to retain their AICPA memberships. Although the proposal garnered an impressive 61 percent affirmative vote, that fell short of the two-thirds required to effect a bylaw change.

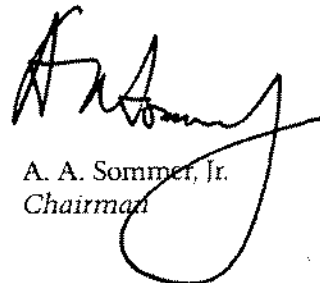
The failure of the Institute's membership to approve this proposal was disappointing. However, the SEC has moved to achieve the same end by proposing that any accounting firm that audits an SEC registrant must be a member of a peer review organization that requires at least triennial peer reviews and has a public oversight body subject to SEC oversight. The Board has strongly endorsed the objective of this proposal since our experience with the AICPA's program has provided us with incontrovertible evidence of the value of peer review in assuring high quality audits.

The year has witnessed continuous improvement in the procedures for conducting peer reviews and in the operations of the Special Investigations Committee. Particularly noteworthy has been the strengthening of the procedures of the latter Committee by the adoption of a more structured investigative approach, coupled with greater flexibility in reviewing documentation related to allegedly failed audits.

On a more personal note, during the past year, Arthur Wood, the last of the original members of the Board, submitted his resignation as chairman and despite the strong urgings of his fellow Board members also resigned from the Board. We miss his wisdom, his experience, his gentle and consistent leadership.

Joining us to replace Art Wood is Robert F. Froehlke. Like Art, Bob has had a distinguished career in business, having recently retired as chairman of the Equitable Life Assurance Society and begun another career as chairman of IDS Mutual Fund Group in Minneapolis. His fellow Board members are delighted that he has consented to add the duties of a Board member to his other substantial commitments.

Respectfully submitted,



A. A. Sommer, Jr.
Chairman

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Highlights and Insights

“ The Public Oversight Board is pleased to be able to report once again that the self-regulatory program of the SEC Practice Section functioned well during 1986-87 under the capable guidance of its committees and is maintaining and improving the quality of practice of its member firms. The Section’s peer reviews have been conducted with thoroughness and when deficiencies in or noncompliance with firms’ systems have been discerned, the Peer Review Committee has been unremitting in insisting that corrective measures be taken. The Special Investigations Committee has conscientiously probed the quality control implications of audit failures alleged in litigation and has demanded changes where its findings indicated that the quality controls needed to be strengthened. The Board is also pleased to report that whenever the Section’s Peer Review or Special Investigations Committees concluded that improvements in the quality control system of a member firm were necessary, the firm promptly and willingly made the recommended changes. ”

The SEC Practice Section of the AICPA Division for CPA Firms is a voluntary membership organization intended for firms that audit SEC registrants, although many firms that have no SEC clients have chosen to become members. The Section is responsible for developing and conducting a program to assure that the quality controls of its member firms are adequate and that they are complied with. The principal tool used to achieve this goal is the triennial peer review to which each member firm must submit. In addition, member firms must comply with stringent membership requirements that also operate to assure enhanced quality in the conduct of audits of SEC registrants.

The Board has carefully overseen the activities of the Section since its inception. In doing this, it has, with the assistance of its excellent professional staff, reviewed the activities of both the Peer Review Committee and Special Investigations Committee through various means. As in past years, Board representatives attended each meeting of the Peer Review Committee and its Evaluations and Recommendations Subcommittee and applied one of its three oversight programs to each of the 127 reviews conducted in 1986.

In the course of performing the 127 reviews, peer reviewers concluded that 12 audits—less than one percent of all those reviewed—were not reported on properly or were not performed in accordance with generally accepted auditing standards. In each case, the Peer Review Committee deferred processing the peer review report until the Committee had been provided evidence that the firm had taken or had planned to take appropriate action.

Evaluation of Quality Control Systems of Firms Peer Reviewed in 1986

<i>No reportable deficiencies noted</i>	<i>10</i>
<i>Corrective action recommended</i>	<i>105</i>
<i>Corrective action <u>required</u> in certain key policies and procedures</i>	<i>12</i>

During the year, the Special Investigations Committee opened or reopened files on 46 cases alleging a firm had failed to conduct an audit of an SEC registrant in accordance with professional standards. It was able to close its files on 50 cases during the year, being assured, where appropriate, that the firms involved had taken appropriate corrective actions, but it referred two of those cases to the Professional Ethics Division for further review of the performance of specific individuals.

A number of improvements have been made in the Section's programs based on accumulated experience and perceived needs. Heed has been paid to the problem of "opinion shopping," which has distressed both the SEC and responsible members of the profession, by adding a new membership requirement and incorporating in the peer review program procedures to assure that member firms have not accommodated "opinion shoppers." Other peer review performance and reporting procedures have also been refined as needed.

Initiatives and proposals to improve the quality of audits were advanced by several entities in addition to the Section: the Securities and Exchange Commission, the "Treadway Commission," the Auditing Standards Board, and the AICPA's "Anderson Committee." The significant audit quality features of each of these initiatives are commented on in the Board's report.

The procedures of the Special Investigations Committee have been more formally structured. Although the Committee focuses on the broad quality control implications of allegations rather than on the specifics of a given case, provision has been made for the Committee and its task forces to access selected workpapers prepared in connection with the audits being litigated. As a result of these strengthened procedures and more detailed reporting to the SEC, the Board is hopeful that the SEC will soon be able to express full confidence in the effectiveness of the special investigations program, as it has with respect to the peer review program.

Summary of SIC Activity

<i>Case files open at July 1, 1986</i>	<i>33</i>
<i>Case files opened or reopened during year</i>	<i>46</i>
<i>Case files closed during year:</i>	
<i>After concluding that allegations had no quality control implications</i>	<i>14</i>
<i>After concluding that the firm's quality controls were not deficient</i>	<i>26</i>
<i>After obtaining assurance that the firm had made or would make appropriate changes in its quality controls</i>	<i>10</i>

<i>Membership</i>	<i>SEC Practice Section</i>	<i>Division for CPA Firms</i>
<i>At July 1, 1986</i>	<i>381</i>	<i>1553</i>
<i>At June 30, 1987</i>	<i>395</i>	<i>1710</i>

The Board commends all of those associated with the Section for their dedication of time, energy, and professional skill to this increasingly effective program to maintain and increase the quality of audits by its member firms. While it is impossible to quantify the number of substandard audits that have been avoided as a result of this program, the experience of those associated with it fully justifies the conclusion that great benefits to the public have flowed from it.

Report of the Board

Introduction and Summary Conclusion

THE PUBLIC OVERSIGHT BOARD is pleased to be able to report once again that the self-regulatory program of the SEC Practice Section functioned well during 1986-87 under the capable guidance of its committees and is maintaining and improving the quality of practice of its member firms. The Section's peer reviews have been conducted with thoroughness and when deficiencies in or noncompliance with firms' systems have been discerned, the Peer Review Committee has been unremitting in insisting that corrective measures be taken. The Special Investigations Committee has conscientiously probed the quality control implications of audit failures alleged in litigation and has demanded changes where its findings indicated that the quality controls needed to be strengthened. The Board is also pleased to report that whenever the Section's Peer Review or Special Investigations Committees concluded that improvements in the quality control system of a member firm were necessary, the firm promptly and willingly made the recommended changes.

Before reporting on the activities of the Board, it is appropriate to comment briefly on the actions that have been taken by others within and without the accounting profession to maintain and improve the quality of auditing in the United States.

During the past year, the role and responsibility of the auditor, and the quality of auditing generally, were the focal points of several major studies and activities. The Auditing Standards Board of the American Institute of Certified Public Accountants issued exposure drafts on ten proposed standards. The major ones, when adopted, will (a) clarify the auditor's responsibility for the detection of errors, irregularities, and illegal acts, (b) clarify the auditor's responsibility for evaluating and reporting on internal controls, (c) provide for expanded communication of matters to audit committees, and (d) establish standards for conducting an examination of management's discussion and analysis. Adoption of these standards will clarify or increase the role of the independent auditor and should enhance further the credibility of the auditor's report.

A wide-ranging study of the financial reporting system in the United States was conducted by the independent National Commission on Fraudulent Financial Reporting chaired by former SEC Commissioner James C. Treadway, Jr. The Commission studied the roles and interrelationships of persons and organizations involved in the financial reporting process in the United States and made a series of recommendations, several of which deal with the role and responsibility of the auditor.

The Securities and Exchange Commission recently published for comment a proposal which would require that financial statements filed with the Commission be certified by an auditor whose accounting and auditing practice has been subjected to an independent peer review within the prior three years.

Several other activities of the American Institute of Certified Public Accountants are directly aimed at improving the quality of audit practice in the U.S. The AICPA Special Committee on Standards of Professional Conduct for Certified Public Accountants issued a report recommending far-reaching changes in the profession's code of professional ethics, mandatory continuing professional education, mandatory participation in a quality review program, and additional educational requirements for entry into the profession. The Council of the Institute has endorsed these recommendations and they are to be submitted to the membership for vote in late 1987.

While the paramount responsibility of the Public Oversight Board is to oversee the activities of the SEC Practice Section, the Board has a keen interest in any and all initiatives to improve the quality of audit practice, including those which originate outside the SEC Practice Section. Because of the far-reaching effects of the ten proposed revisions to auditing standards being considered by the Auditing Standards Board, members of our staff were instructed to monitor closely and report on any and all developments regarding the proposed changes in the role and responsibility of the auditor. In addition, members of the Public Oversight Board, either individually or as a body, met with several other groups to discuss the issues and current developments regarding the accounting profession and its self-regulatory program.

The primary objective of the SEC Practice Section of the AICPA Division for CPA Firms is to maintain and improve the quality of the accounting and auditing practice of member firms before the Securities and Exchange Commission. This annual report describes the Board's oversight of the Section's programs, the initiatives of the Section and those of other organizations to maintain and improve audit quality. The Board neither has nor needs line authority over the Section. Our suggestions for the development and refinement of the policies, standards, and operations of the Section are given serious consideration by the Section and are generally adopted. The Section's activities are described in greater detail in the appendices.

Board Activities

The Board consists of five members who are not involved in the public accounting profession and whose backgrounds provide a broad spectrum of experience.

Arthur M. Wood, who was the last remaining charter member of the Board, retired from the Board effective December 31, 1986. A. A. Sommer, Jr., who had been vice chairman, was elected to succeed Mr. Wood as chairman and Robert K. Mautz was elected vice chairman. Robert E. Froehlke joined the Board in July 1987. Melvin R. Laird and Paul W. McCracken continued their services as Board members.

The Board chairman attends meetings of the Section's Executive and Planning Committees. Mr. Mautz is the Board's liaison with the Special Investigations Committee and attends most of its meetings and some meetings of its task forces. Other Board members also occasionally attend meetings of the Section's committees.

The Board is assisted by a staff of four experienced CPAs and two administrative personnel. Richard A. Stark, a partner in the New York law firm of Milbank, Tweed, Hadley & McCloy, has served as the Board's legal counsel since its inception.

The Board meets monthly to consider issues as they arise and to review events since the last meeting. During the year, the Board also met formally or informally with various individuals or groups to discuss the Section's self-regulatory program and other initiatives to improve audit quality.

- In July 1986, the Board met in open meeting with members of the Securities and Exchange Commission which oversees private sector processes for setting accounting and auditing standards as well as the activities of the SEC Practice Section. The meeting was used to exchange views on the effectiveness and credibility of the special investigative process, the performance of management advisory services for audit clients, and other issues of mutual interest. It is the intention of the Board to meet annually with the Commission to discuss topics of current interest.
- In July 1986, the Board met with the Honorable Charles A. Bowsher, Comptroller General of the U.S. to exchange views on the quality of audits of governmental agencies, disciplinary actions taken by accounting firms, and other issues.
- In July 1986, the Board convened a meeting of the house counsels of eleven major CPA firms to discuss the special investigative process and the effects of proposed changes in auditing standards on litigation risk of CPA firms.

Board Members



▶ **Arthur M. Wood, Chairman, 1984-86; charter member of the Board, Chairman of the Board and Chief Executive Officer of Sears, Roebuck and Co., 1973-78.**

◀ **A. A. Sommer, Jr., Chairman, 1986-; joined Board in 1983; SEC Commissioner, 1973-76; Partner in Washington, DC law firm of Morgan, Lewis & Bockius specializing in securities law.**



▼ **Robert K. Mautz, Vice Chairman, joined Board in 1981; Professor Emeritus of the University of Illinois and the University of Michigan.**



◀ **Melvin R. Laird, joined Board in 1984; nine-term U.S. Congressman, 1953-69; Secretary of Defense, 1969-73; Counsellor to the President, 1973-74; Senior Counsellor for National and International Affairs, The Reader's Digest Association, Inc.**

▶ **Paul W. McCracken, joined Board in 1985; Chairman of the President's Council of Economic Advisers, 1969-71; President of the American Enterprise Institute for Public Policy Research, 1986; Edmund Ezra Day Distinguished University Professor Emeritus of Business Administration, Economics, and Public Policy at University of Michigan.**



Legal Counsel

▼ **Richard A. Stark, Legal Counsel to Board since 1977; partner in New York law firm of Milbank, Tweed, Hadley & McCloy specializing in securities law.**



▶ **Robert F. Froehlke, joined Board in 1987; Secretary of the Army, 1971-73; Chairman of the Board of Equitable Life Assurance Society, 1982-87; President and CEO of IDS Mutual Fund Group.**



Staff Members

Louis W. Matusiak, Executive Director since 1978; partner in Alexander Grant & Company, 1964-78; Director of Professional Development, AICPA, 1958-64; Professor, University of Detroit, 1950-57, Chairman of Accounting Department, 1953-57.



Charles J. Evers, Technical Director since 1980; senior staff member of FASB, 1977-80; Peat, Marwick, Mitchell & Co., 1961-77, audit partner in New York office, 1971-77.



Alan H. Feldman, Assistant Technical Director since 1980; Touche Ross & Co., 1969-80, Director of Professional Standards Review in Boston office, 1978-80.



John F. Cullen, Assistant Technical Director since January 1987; Manager, AICPA SEC Practice Section, 1979-81; Associate Director of Quality Control, KMG Main Hurdman, 1981-87.



- In January 1987, the Board met with Auditing Standards Board Chairman Jerry Sullivan and AICPA Vice President Dan Guy to discuss audit quality initiatives to close the "expectation gap" concerning auditor responsibility and performance.
- In February 1987, the Board met with Michael Barrett, chief staff aide to Congressman John J. Dingell, Chairman of the Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce, to review current developments in the accounting profession's self-regulatory program and initiatives undertaken to improve the quality of audit practice.
- In March 1987, the Board met with John C. Burton, former SEC Chief Accountant and currently Dean and Arthur Young Professor of Columbia University Graduate School of Business, to discuss the objectives of self-regulation.
- In April 1987, the Board met with Wallace E. Olson to gain the benefit of his views and perspectives on the effectiveness of the self-regulatory program and the role of the Board. Mr. Olson, who was then AICPA President, played a key role in the establishment of the Division for CPA Firms.
- In May 1987, the Board met with representatives of the Section to discuss the concurring partner review membership requirement.

Throughout the year, Chairman Sommer maintained an active liaison with members and staff of the Securities and Exchange Commission and the National Commission on Fraudulent Financial Reporting.

Such meetings provide the Board with valuable outside perspectives to supplement the detailed written and oral reports of its staff. Thus, the Board has general access to information and viewpoints essential in evaluating the effectiveness of the Section's self-regulatory program and the adequacy of initiatives affecting the profession.

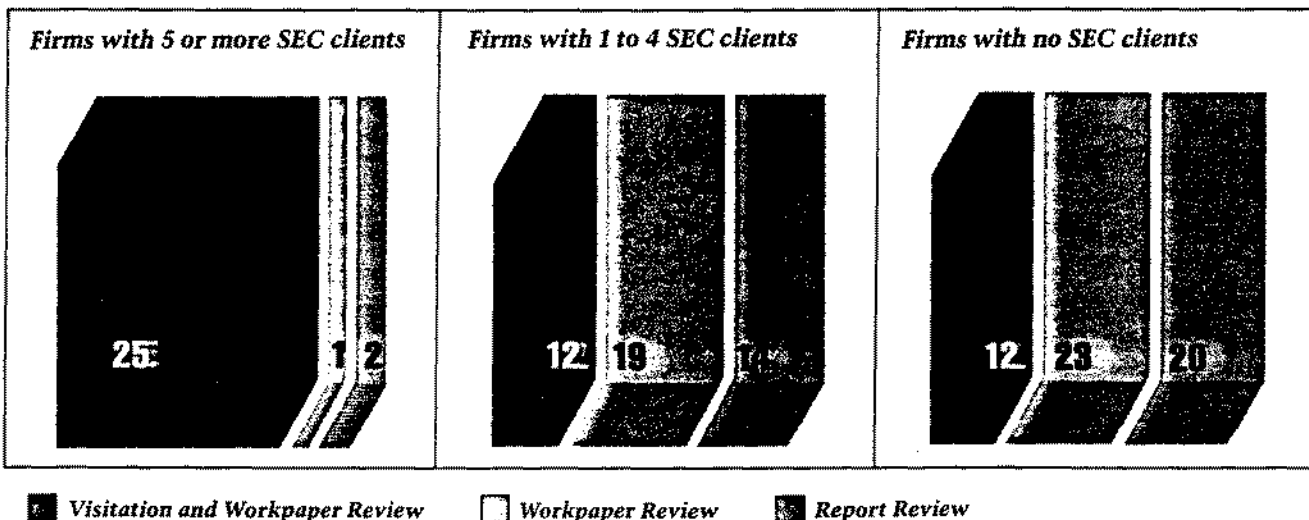
Oversight of the Peer Review Process

The Board and its staff monitor all activities constituting the peer review process. Representatives of the Board attend meetings of the Peer Review Committee and its Evaluations and Recommendations Subcommittee and the Board's staff reviews each peer review performed.

As in prior years, one of the POB's three oversight programs was used to evaluate the performance on each peer review conducted in 1986:

- Visitation and workpaper review program—observation of the performance of the field work, attendance at the exit conference during which the review team reports its findings and recommendations to management of the reviewed firm, and review of the review team's workpapers, reports, and the reviewed firm's response, or
- Workpaper review program—review of the review team's workpapers and reports and the firm's response, or
- Report review program—review of the review team's reports and selected portions of its workpapers, and the firm's response.

Scope of Board Oversight of 1986 Peer Reviews Classified by Number of SEC Registrants Audited by Reviewed Firms



The specific oversight program applied to a given review is determined by a number of factors including:

- Attributes of the reviewed firm:
 - Number of SEC registrants it audits.
 - Size of its professional staff.
 - Number of times it has been peer reviewed and type of report received on its last review.
 - Type of POB oversight program used to evaluate its prior review.
- Attributes of the review team:
 - Performance of team captain on prior reviews.
 - Type of POB program used to evaluate the team captain's performance on prior reviews.

Application of this approach results in some reviews being assigned automatically to the visitation-workpaper review program. The type of oversight program assigned to other reviews is on a random basis.

When the visitation-workpaper review program is applied to the review of a multi-office firm, the program calls for POB staff to observe the performance of the review team at one or more operating offices, to attend exit conferences held at such operating offices, and to attend the final conference at which the review findings are reported to top management. As a result, POB staff

members, at times accompanied by a Board member, attended a total of 76 operating and final exit conferences held in conjunction with reviews of the 49 firms to which the POB applied its most intensive oversight program.

Representatives of the Board attended each of the five meetings the Peer Review Committee held during the year. POB representatives also attended each meeting of the Evaluations and Recommendations Subcommittee. Based in large part on the review by AICPA staff of the review teams' workpapers, the Subcommittee recommends whether the Committee should accept the review team's report as submitted and whether such acceptance should be conditioned upon the reviewed firm agreeing to take specified corrective action. The Board's staff communicates the results obtained from the application of its oversight programs to the Subcommittee and occasionally to the full Committee. All differences of opinion between the POB staff and the Committee as to whether an individual review was conducted and reported on in accordance with standards are reported to and discussed in detail by the Board.

The Board finds its access to the peer review process of the Section entirely satisfactory. Since POB representatives have "privilege of the floor," the POB's views are made known and considered by the Committee in making its decisions on setting or revising established standards and administrative procedures. Discussion at Committee meetings is free and frank. Board and staff members have adequate opportunity to express their views and criticisms which are duly considered by the Committee.

An important procedural change was made during the year at the Board's suggestion. While Committee members had previously abstained from voting on the acceptance of peer review reports in which they had an interest as either a member of the review team or reviewed firm, the Committee changed its administrative procedures to require such Committee members to absent themselves during the Committee's discussion of the peer review report.

The Board is convinced that the peer review program is functioning effectively and accomplishing the purposes for which it was intended.

The Board's staff also evaluates the Committee's monitoring program. In cases where the review team uncovered significant negative findings, the Committee requires the firm, as a condition for accepting its peer review report, to take specific corrective action and to provide evidence to the Committee that such action achieved the intended result. The Board commends the review teams for their diligence in requiring firms to adhere to standards. The Committee is also to be commended for its insistence that each and every review be performed and reported on in strict accordance with standards and for its insistence that firms whose quality control systems are found to be in need of significant revision provide the Committee with evidence that appropriate corrective actions have been implemented effectively. However, the Board is concerned about the amount of time it takes to resolve problems encountered in some reviews. As a result, there is delay in requiring such firms to implement the corrective actions considered necessary. Sixteen reports of 1986 peer reviews were unprocessed as of June 30, 1987, even though the field work for all but one of these reviews was completed at least five months earlier. The Board has urged the Committee to examine its procedures and take such action as may be required to expedite the processing of problem reviews.

Improvements in Quality of Practice Peer review is enhancing the quality of accounting and auditing services performed by member firms. Most firms that were reviewed in 1986 and had had a prior review had improved their quality controls and compliance therewith; however, seven firms received a less desirable report. The Board especially commends five firms, each of whom had made significant improvements in its quality control system following receipt of a qualified report in the prior review so as to receive an unqualified report in 1986.

The Board notes, however, that three firms that had received qualified reports on their prior reviews had not implemented effective corrective actions and thus received qualified reports again in 1986. Two of the reviews were accelerated reviews; the third firm, whose prior review had been in 1983, had been found on an earlier revisit by the team captain to have implemented revised policies and procedures and corrected the deficiency. The 1986 review team concluded,

however, that the firm had reverted to its former practices, thus resulting in the firm's receiving another qualified peer review report. The Committee is subjecting the corrective action plans of these three firms to extensive and intensive monitoring. The Committee is also planning to monitor the implementation of the action plans of the seven firms that had received unqualified reports on their prior reviews but received qualified reports in 1986.

The situations described in the preceding paragraph evidence the need for a firm to have its quality control system independently reviewed every three years and for the Peer Review Committee to obtain assurance that a firm is effectively implementing corrective actions, when such corrective actions are considered mandatory to give the firm reasonable assurance of conforming with professional standards in the performance of accounting and auditing engagements.

Ninety seven firms reviewed in 1986 received unqualified peer review reports as they had in 1983. However, all but nine of these firms received a letter of comments concerning their quality controls or compliance therewith.



(Left) SECPS Executive Committee Chairman John Abernathy attended a small group luncheon to express the Section's appreciation to outgoing POB Chairman Art Wood and to congratulate Al Sommer on being named Mr. Wood's successor. (Right) AICPA President Phil Chenok with POB members Mel Laird and Bob Mautz at outgoing POB chairman's "farewell lunch."

In an attempt to quantify the improvement in quality of practice effected as a result of the peer review process, the Board's staff coded and analyzed the deficiencies reported in the letters of comments issued to firms reviewed in 1986 and those reported in letters of comments issued to these firms on their immediately prior peer review. After excluding comments relating to application of auditing standards that became effective within the three-year period, our analysis showed a marked decline in deficiencies relating to the element of supervision. As a result, engagements reviewed in 1986 had considerably fewer instances of misapplication of generally accepted auditing standards. On the other hand, deficiencies in planning audits increased, reflecting, we believe, evaluation by the peer review process of compliance with Statement on Auditing Standards No. 47, "Audit Risk and Materiality in Conducting an Audit," which was required to be applied for audit periods beginning after June 30, 1984. Similarly, there was an increase in deficiencies cited in the conduct of audits relating to audit sampling which, we believe, reflects reviewer evaluation of compliance with Statement on Auditing Standards No. 39, "Audit Sampling," which was required to be applied on engagements with periods ending on or after June 25, 1983.

The fact that there is need for improved audit planning and conduct of audits in those respects further underscores the value of peer review as a mechanism that enforces compliance with new or revised auditing standards. It is apparent that there is a learning curve in the implementation of new standards across all firms from the largest to the smallest. Peer review, we believe, accelerates the learning and implementation processes. Our Board believes that this will be especially significant to the public interest as firms discharge their audit responsibility when and if the ten new standards now being considered for issuance by the Auditing Standards Board are adopted.

The Board strongly believes in the importance of private regulation, that is, the internal

monitoring and review and resultant quality control improvement that occurs within firms. For that reason, we were disappointed by a rise in deficiencies concerning the internal inspection program of firms particularly with respect to the timeliness of inspection and implementation of corrective action by some firms. We applaud the strong action taken by the Peer Review Committee which has required such firms to demonstrate improved quality in these respects by having to submit future performance of their inspections to Committee oversight.

In summary, our analysis of comparative peer review results and first-hand impressions gained through our staff oversight program lead us to conclude that peer review has had and will continue to have an important role in the enhancement of quality controls of Section member firms. The Board has made the details of its special analysis available to the Committee for its use in providing guidance to review teams.

Concurring Partner Review The Board believes that review of an audit engagement by a partner in addition to the engagement partner can and should provide a firm with significant additional assurance that its engagements are performed in all material respects in accordance with professional standards. Review by a second or concurring partner, however, is required only for audits of SEC registrants and certain other specified types of companies performed by firms that are members of the SEC Practice Section. Neither generally accepted auditing standards nor quality control standards require that audits be subjected to review by a partner other than the engagement partner.

The concurring partner review membership requirement has recently been strengthened by the Section—in large part at our urging—essentially to require that certain workpapers as well as the audit report and financial statements be subjected to review by the second partner. The effectiveness of the implementation of the expanded requirement will be first tested in peer reviews conducted in 1987.

An analysis made by the Board's staff revealed a wide variation in the procedures adopted by firms to assure compliance with the concurring partner review membership requirement. A firm is allowed considerable discretion in defining the procedures that its concurring reviewers are to perform; further, each firm is allowed to stipulate the degree or amount of additional assurance it is to derive from review by the concurring review partner.

As a result, the Board met in May 1987 with representatives of the Section's Peer Review and Special Investigations Committees to discuss the Board's analysis. That discussion confirmed the existence of wide differences of opinion among CPA firms as to how much additional assurance a concurring partner review should provide and the amount of responsibility that the concurring reviewer should be assigned for the quality of the audit. Such differences exist even among the large national firms. We were further advised that very few firms charge a concurring reviewer with responsibility for doing so comprehensive a review as to provide the firm with positive assurance that the audit was conducted in accordance with generally accepted auditing standards and that the financial statements were prepared in all material respects in accordance with generally accepted accounting principles. However, the Board notes that the National Commission on Fraudulent Financial Reporting seems to concur that these are appropriate objectives of a concurring partner review. The Commission recommends that such review should provide the firm with assurance that the audit was designed (and performed) so as to detect fraudulent financial reporting.

The Board is concerned about the differences regarding the degree of assurance that a concurring partner review should provide. We are aware that two firms can have equally effective



SECPS Peer Review Committee Chairman Dave Pearson, shown with POB Chairman Al Sommer, headed a small delegation of Section representatives to discuss the concurring partner review requirement at the May 1987 Board meeting.

quality control systems and yet have quite different quality control procedures. Further, equally effective methods of documenting the results of auditing procedures—i.e., the form, content, and organization of workpapers—can and do vary widely among firms. Thus, the Board recognizes the difficulty inherent in specifying procedures that all firms should require of their concurring review partners. However, the Board believes that the Section should more clearly define the degree of assurance that a concurring review should provide and has urged the Section to give further consideration to clarifying the objective of concurring review.

The Board concurs with the National Commission's recommendation that the scope of the concurring review should be designed to reduce the incidence of fraudulent financial reporting. The Board believes that a concurring partner review should be required of all auditing firms, or alternatively at a minimum to audits of public companies. Accordingly, we have recommended that the Auditing Standards Board consider incorporating a concurring partner review requirement into the quality control standards, and issuing guidance to firms as to how and when it should be applied.

Oversight of the Special Investigative Process

The Special Investigations Committee (SIC) was organized late in 1979 as a supplement to the peer review program. The SIC grew out of the belief by the Section that when a suit was brought against a Section member, *immediate* inquiry should be made as to whether the charges might indicate a deficiency in the firm's quality controls or its compliance with them or whether they might indicate a need for clarification of professional standards. Thus, the Section adopted a membership requirement calling on member firms to promptly report to the Section any suit brought against them or their personnel either by the SEC or a private party involving the audit of a client that files financial reports with the SEC or other government regulators pursuant to SEC regulations.

The purpose of the special investigative process is not to investigate whether the charges in the suit are justified. Those determinations are made by the SEC and the civil courts. For the Section or the SIC to undertake such an inquiry and determination would be a costly and needless duplication of processes that already exist.

A task force of SIC members is assigned to each case. The task force reads the financial statements in question and reviews other available relevant information and applicable accounting and auditing literature.

In many cases it is clear from a mere reading of the complaint that the charges made have no relevance to the work of the auditor; for instance, they do not charge any departure from accounting principles or auditing standards.

When the complaint does allege an audit failure, the task force initiates discussions with members of the defendant firm (frequently including personnel associated with the subject audit) concerning the case and often examines relevant guidance materials issued by the firm. If through these procedures the task force is unable to satisfy itself that the firm's quality controls, as they relate to the allegations in the suit, are adequate, the task force may recommend to the SIC that a "special review" be performed with respect to all or only to specific relevant quality controls of the firm. If at any stage the task force determines that the firm is deficient in its quality control procedures or compliance with them, it will recommend to



POB Vice Chairman Bob Mautz frequently attended meetings of the SIC in his capacity as Board liaison to the Special Investigations Committee.

the SIC that the firm be required to take the necessary corrective measures, and these recommendations are typically confirmed by the Committee. In every instance to date, the firms have complied with demands and suggestions made.

Oversight of SIC Activities in 1986-87 The Board exercises close oversight of the activities of the SIC. Vice Chairman Robert K. Mautz has served as the Board's liaison to the SIC for several years, and members of the staff have attended all such meetings as well as most task force meetings. The staff typically reads the financial statements pertinent to the case, related correspondence, relevant accounting and auditing literature, and usually attends meetings with firm personnel to discuss quality control implications of the allegedly faulty engagement.

Members of the Board's staff, often accompanied by Mr. Mautz, attended (a) each of the six meetings held by the Committee during the year, (b) a substantial majority of meetings of SIC task forces with representatives of firms involved in litigation to discuss allegations in reported cases, and (c) ten of the eleven meetings SIC task forces held with the captain of the firm's peer review team either to discuss the results of the firm's previous peer review in the light of the allegations, or to review and discuss the scope of an imminent peer review and later the results of such review.

The staff furnishes to the Board memoranda prepared by SIC staff for all cases which include summaries of the allegations, the accounting and auditing issues involved, their judgments with respect to the significance of the litigation, and the bases for those conclusions. The SIC's activities with respect to cases are reviewed at monthly Board meetings to determine whether the SIC is properly fulfilling its responsibilities.

Enhancing Credibility of the Process As noted elsewhere in this report, the SEC has in its most recent report to Congress once more stated its confidence in the peer review process. However, it has been unable to so state with regard to the SIC process.

This inability has stemmed largely from the Commission staff's concern whether the SIC has access to sufficient information to permit it to make appropriate judgments, and from the staff's conclusion that it did not have access to sufficient information about the activities of the Committee to permit the Commission to exercise its oversight role.

These difficulties have their roots in the peculiar sensitivity of the environment in which the SIC conducts its activities.

Like all litigants, member firms are extremely reluctant to do anything they think may jeopardize their ability to defend against charges made against them. This sensitivity has been heightened in recent years as the amounts of settlements and judgments have escalated sharply. Consequently, when the SIC was organized it was understood that, as mentioned, the process would not eventuate in a judgment concerning the quality or adequacy of the questioned audit. Further, the firms were also concerned that if the SIC were given access to the documentation related to such an audit for purposes of review, the Committee's personnel who examined the documentation might be compelled to give testimony concerning their review and any conclusions they drew from it, even if their function was not to reach any such conclusion.

Thus, it was initially understood that the SIC would not have access to the workpapers associated with an allegedly failed audit. However, neither the Section nor the Board felt that this condition unduly inhibited the work of the SIC, since alternative procedures were available to permit the assembly of information from which a sound judgment might be made concerning the adequacy of a firm's quality control policies and procedures and its compliance with them as related to a complainant's allegations. For instance, SIC task forces have, where appropriate, reviewed other audits performed by the personnel associated with the audit in question, audits performed by the firm of entities in the same industry as the client for which the allegedly failed audit was performed, and audits performed by the same office. Through these and other means, the SIC has been able, to the Board's satisfaction, to determine when allegations suggested possible quality control problems in the firm.

However, it was perceived that the lack of access to relevant papers associated with the questioned audit created an inefficiency in the process, and, moreover, created uncertainty in

some quarters whether all was indeed being done that could be done to assure the effectiveness of the SIC's program.

Reevaluation and Subsequent Revision of the Process The Board carefully reviewed with its counsel, Milbank, Tweed, Hadley & McCloy, the problems associated with expanding SIC access to documentation associated with an audit involved in litigation. Next, in the summer of 1986, the Board asked the counsel for the firms represented on the Section's Executive Committee to meet to discuss the matter. At that meeting, which was characterized by a professional discussion of outstanding candor, forthrightness, and competence, there emerged the outlines of an approach to access which hopefully promote a more efficient and effective SIC process and answer the concerns of those who felt there should be greater access.

To deal further with these matters, the Section's Executive Committee appointed the Task Force on SIC Methodology. The task force, headed by Mr. Frank Rossi, Vice Chairman of Arthur Andersen & Co. and a member of the Executive Committee, included another member of the Executive Committee, one former and one current member of the SIC, and two attorneys who serve as house counsel to firms represented on the Executive Committee.

After extensive deliberations, all of which were attended by members and staff of the Board and which were reviewed carefully and critically at Board meetings, the task force made its report to the Executive Committee in April 1987, which approved it and, with a minor change, implemented its recommendations.

The recommendations adopted by the Executive Committee were these:

First, a more "structured" procedure was adopted. This approach describes the procedures that should be followed in the various stages of inquiry. It also spells out with reasonable precision the factors that should be considered in deciding whether to proceed to the next stage—i.e., general inquiry, in-depth inquiry, and special review—or to close the file on a case.

Second, the SIC, when it deems it appropriate in connection with its inquiries, is to be given access to certain audit documentation, such as audit planning and consultation memoranda and summary reviews of audit issues, that might enable the Committee to evaluate whether appropriate attention was given by appropriate individuals during the course of the audit to the issues addressed by the allegations. There may be instances in which a firm believes providing such access may seriously jeopardize its litigation posture. In such cases, the task force must use other means, which may include a special review, to satisfy itself concerning the adequacy of the firm's quality controls and compliance with them. The Board intends to review closely those instances in which requests for access are denied and, if it concludes a refusal is unwarranted or seriously impedes the work of the SIC, it will urge upon the Section the adoption of stronger incentives for firms to provide access.

Third, more comprehensive and informative summaries will be furnished to the SEC when a case is closed. The Commission staff has felt that the summaries furnished under earlier arrangements did not provide them with the information necessary for them to carry out their oversight function. The new summaries will include a delineation of the specific



Proposed revisions to auditing standards was the subject of discussion among Auditing Standards Board Chairman Jerry Sullivan, AICPA Vice President-Auditing Dan Guy, POB Chairman Al Sommer, POB Executive Director Lou Matusiak and POB Vice Chairman Bob Mautz.

issues considered (including those identified in any SEC releases relating to the case), the interviews conducted, the types of audit documentation reviewed, and the bases for the SIC's conclusions.

Fourth, the SIC will meet regularly with the Commission staff to discuss SIC policies and procedures, concerns the staff may have with actions taken on case files which have been closed, and any changes the Commission believes would make the process more effective.

The Board has since the inception of the SIC had full access to the SIC process and has been able to satisfy itself that this part of the Section's program has been carried out satisfactorily in accordance with the mandate given the SIC. The inability of the SEC to accord it the confidence it has accorded the peer review process has been a continuing source of concern to the Board, and as a consequence the Board has diligently urged and pursued a course intended to gain the Commission's confidence in the SIC.

The Board is hopeful that as the new procedures are implemented the Commission and its staff may gain the level of confidence in the SIC process that the Board has. In its most recent published report, the SEC notes that: "The Commission is encouraged by the continuing efforts to improve the SIC process."¹

Scope of Services By CPA Firms

In November 1986, the Board publicly distributed a report prepared by a professional research organization entitled, *Public Perceptions of Management Advisory Services Performed by CPA Firms for Audit Clients*. While no instance of impaired auditor independence or objectivity related to the rendition of management advisory services (MAS) had come to our attention, the Board initiated this research study because it is concerned that the continuous expansion of consulting services may be perceived as impairing auditor independence and adversely affect the value of the audit function over time.

In preparation for the survey, the Board obtained promotional materials, advertisements, and other information from firms, and identified the types of services being offered. The survey included a sample of such services. The survey responses indicated that key public groups perceive that certain types of MAS are likely to impair auditor objectivity and independence. About half or more of respondents in each of the key public groups surveyed indicated that the following engagements, when performed for an audit client, could cause a "great deal of" or "some" impairment:

- Negotiating mergers, acquisitions, and divestitures (76%)
- Performing actuarial services which directly affect amounts involved on the balance sheet (64%)
- Implementing a strategic plan (63%)
- Identifying merger and acquisition candidates (62%)
- Valuing assets acquired in a business combination (61%)
- Executive search for senior management personnel (56%)
- Renegotiations or redetermining price under procurement contracts (50%)
- Developing a strategic plan (49%)
- Developing an executive compensation plan (47%)

In response to a survey question, audit committee chairmen indicated that their committees review MAS engagements performed by their auditors for impairment of auditor independence and, for the most part, conduct such review before the services are performed. In that connection, it should be noted that data on MAS fees are required to be reported by member firms to the audit committees of SEC registrants and to the Section for its public files. The latter data indicates that almost 80 percent of the SEC registrants audited by SECPS member firms obtain no MAS services from their auditor.

The Board published the report without comment and indicated that the results of the survey may be useful to the Section as well as to individual firms in deciding what action, if any, should be taken to change the perceptions of various groups caused by performance of certain types of MAS engagements. The Board believes that the information contained in the Board's report will also be useful to firms in developing policies for the rendition of advisory services and to companies in making judgments in these instances.

The Board continues to observe with keen interest the continual growth in consulting

services provided by accounting firms and the effect that such activity has on their operations and on the public. A recent article in *Forbes* magazine epitomizes the Board's concern:

"Happily, accounting remains for now at least one of the nation's most admired professions, as shown by a recent Louis Harris poll of shareholders and business leaders who believed accounting to have the highest moral practices of any major profession—better than college professors, lawyers, congressmen, journalists.

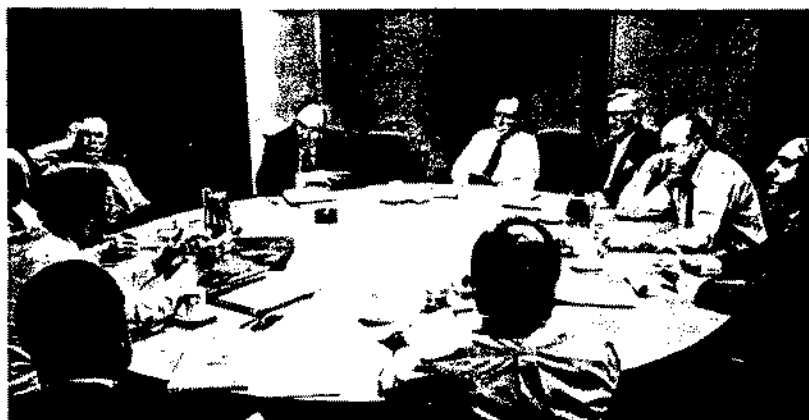
Yet if something happens to that credibility, there is more at risk than simply the fortunes of the men and women in the green eyeshades. In theory, it is fine if accounting firms want to pursue opportunities in related business fields like strategic or financial consulting. There's even a strong contingent of thought that such endeavors will help the firms better understand their clients—and as a result do better audits for them. But the stakes involved are huge. In the practical world of the marketplace, certified public accountants are the only guarantors of financial integrity the capitalist system has. The further the industry strays from its roots, the bigger the chance of doing damage to its credibility with the public, and that is something from which ultimately no one can profit."²

Other Initiatives to Improve Quality of Audit Practice

Considerable effort has been expended by various entities this past year to enhance audit quality particularly in the development of auditing standards designed to eliminate the insidious practice of "opinion shopping," to close the expectation gap concerning auditor responsibilities, and to improve the quality of auditing and expand the role of the auditor.

Minimizing Instances of Opinion Shopping The concept of obtaining a second professional opinion is generally accepted in certain fields, especially that of medicine. A second opinion guards against following the advice of an ultra-conservative or ultra-liberal. In this context, it is proper for management to seek a second opinion on the application of generally accepted accounting principles in situations where professional literature is not explicit. However, application of this concept does not condone continuance of the search until one finds an auditor who will agree with management's desired accounting treatment, a practice generally referred to as "opinion shopping." The profession has taken several decisive actions to eliminate, or at least minimize, this sort of abuse.

During 1986, SECPS member firms were required to establish policies and procedures for their personnel to follow whenever a non-client requests an opinion on the application of an accounting principle. Such procedures generally require consultation with designated specialists in the firm and assignment of designated partners to monitor adherence to such policies and procedures. Peer reviewers are now required to test the firm's compliance with such established policies and procedures.



Wally Olson, who as AICPA President played a vital role in the creation of the Division for CPA Firms, was invited to discuss with the Board suggestions for improving the credibility and effectiveness of the accounting profession's self-regulatory program.

In July 1986, the Auditing Standards Board issued an auditing standard, "Reports on the Application of Accounting Principles," which requires all practitioners to follow procedures similar to those formerly required only of SECPS member firms, including required consultation with the "shopper's" accountant to ascertain whether the auditor asked to express an opinion has been given all the facts relevant to rendering a professional judgment. The issuance of this standard obviated the need for a specific membership requirement; accordingly it was dropped in December. However, the Board is pleased to note that enforcement of the auditing standard will be given

high priority in SECPS peer reviews.

The Section recently revised its peer review program to require peer reviewers (a) to obtain a list of SEC engagements accepted by the firm since the last peer review where, as reported in a Form 8-K or similar public filing, the former accountant resigned or there was a reported disagreement on an accounting or reporting matter and (b) to ascertain if any opinion on the application of generally accepted accounting principles was rendered prior to acceptance of the entity as an audit client and, if so, whether such opinion was issued in accordance with the firm's procedures. In addition, peer reviewers are required to review current or prior period workpapers to the extent necessary to evaluate whether any matters which led to resignation of the predecessor auditor or which were the basis for a disagreement were handled appropriately. We believe these procedures will minimize the instances of auditors accommodating "opinion shoppers" and will enable reviewers to detect situations where the successor auditor accommodated an "opinion shopper."

Closing the Expectation Gap There has long been a wide difference of opinion between users of audited financial statements regarding an auditor's responsibilities and the auditor's own view of what those responsibilities are. The Board believes that significant progress was made this past year to close this so-called "expectation gap." The Board commends the Auditing Standards Board for its diligent efforts to both improve auditing standards and procedures and more clearly define auditors' responsibilities.

In February 1987, the Auditing Standards Board exposed for public comment ten new standards which, among other things, are designed to clarify the auditor's responsibility for and enhance detection of fraud, improve auditor communications with financial report users and with audit committees, and provide early warning about possible financial failure. These proposals offer guidance to auditors to improve the effectiveness of audits, a subject which has been a matter of concern to both the House Subcommittee on Oversight and Investigations and the National Commission on Fraudulent Financial Reporting.

Mandatory Peer Reviews While member firms of the SEC Practice Section audit a predominant majority of the financial statements of public companies (see Appendix D), the Board believes the public interest would be best served if all auditors, especially those of public companies, were required to undergo peer review periodically. The Board has continually expressed the hope that this could be accomplished voluntarily throughout the profession. Consequently, the Board applauded the actions of the AICPA Board of Directors and Council in recommending that the AICPA's bylaws be amended, as the Special Committee on Standards of Professional Conduct for Certified Public Accountants had urged. If so amended, the bylaws would have required that a member in public practice as a partner, shareholder, or proprietor in a firm auditing one or more SEC registrants could retain an individual membership in the AICPA only if the member's firm were a member of the SEC Practice Section.

The Board was perplexed and disappointed by the results of the balloting—perplexed that only 54 percent of the members cast a ballot on so important an issue (only 130,000 of the estimated 240,000 members voted), and disappointed that the proposal was not favorably voted on by the two-to-one margin necessary for a bylaw change (the proposal received a 61 percent favorable vote).

The Board will be disappointed if the Institute membership rejects the recommendation of the Special Committee on Standards of Professional Conduct for Certified Public Accountants (the "Anderson Committee") that would require, as a condition for AICPA membership, participation by the member's firm in the Institute's quality review program. If adopted, firms joining the quality review program would be required to undergo an independent review of their quality control policies and procedures and compliance therewith every three years.

The Board believes peer review is the most effective means available to a profession to improve and maintain the quality of service its members provide. Our extensive involvement with the peer review program of the SEC Practice Section has convinced us that it works and works well. Therefore, we are gratified by the actions of the National Commission on Fraudulent Finan-

cial Reporting³ and the SEC⁴ in endorsing the objective that all public accounting firms that audit public companies should belong to a professional organization that requires periodic peer reviews.

The Board urges, however, that any implementation of a mandatory peer review program be accomplished within a self-regulatory framework. We see no need for the SEC to require a rigid or very structured relationship with a peer review organization since the SEC has found its current access to the Section's peer review process sufficient for it to form its own independent judgment regarding its effectiveness.⁵ The Board has expressed these views to the Securities and Exchange Commission. A copy of our comment letter to the SEC on its proposal is reproduced as Exhibit I.

National Commission on Fraudulent Financial Reporting Private sector concerns about incidences of fraudulent financial reporting resulted in appointment of an independent commission to study the causes of fraudulent financial reporting and recommend steps to reduce its incidence. In April 1987, the Commission, known as the National Commission on Fraudulent Financial Reporting, under the capable chairmanship of former SEC Commissioner James C. Treadway, Jr., published a report for public comment which contains a series of proposed recommendations to curb such practice. We applaud the Commission's diligent and practical consideration of the complex issues of fraudulent financial reporting and generally support its recommendations.

We have provided written comments to the Commission on those recommendations that directly or indirectly bear on the accounting profession's self-regulatory program:

- Improving audit quality
- Concurring partner review
- Peer review
- Regulation of the public accounting profession
- Role of an audit committee vis-a-vis management advisory services by auditors

Our views on these matters are expressed in various sections of this report. A copy of our comment letter is reproduced as Exhibit II.

The Board is hopeful and optimistic that the proposals of the National Commission and the Auditing Standards Board will be adopted, especially those that are designed to prevent auditors from accommodating "opinion shoppers" and those that will reduce the differences between the responsibilities the accounting profession believes an auditor should have and the responsibilities that users of audited financial statements believe auditors should have.

The Board is also hopeful that the number of firms that subject their quality control systems to peer review will continue to increase. Accordingly, as indicated, we support the mandatory quality review recommendations of the Anderson Committee and the objective of the SEC's proposal regarding mandatory peer review.

Conclusions

We believe the matters discussed in this report offer convincing evidence that peer regulation is effective. The Section deserves much credit for the effective mechanisms it has put in place to test and monitor the professional accounting and auditing practices of member firms who must deal with and help solve the myriad of complex problems created by the dynamic business world. As we have said in the past, peer regulation is working and working well to maintain and improve the quality of audit practice of firms that participate in this voluntary peer review program.

FOOTNOTES

1. U. S. Securities and Exchange Commission, Fifty-Second Annual Report, 1986, p. 26.
2. Greene, Richard, "Blood on the Ledger," *Forbes*, May 18, 1987.
3. Report of the National Commission on Fraudulent Financial Reporting, Exposure Draft, April 1987.
4. Release 6695, Securities and Exchange Commission, April 1987.
5. "The Commission believes the peer review process contributes significantly to improving the quality control systems of member firms and thus should enhance the consistency and quality of practice before the Commission." U. S. Securities and Exchange Commission, Fifty-Second Annual Report, 1986, p. 25.

Exhibit I

POB Comment Letter on SEC Proposal for Mandatory Peer Reviews

The Public Oversight Board is pleased to comment on the Commission's proposed amendments to its rules that would require that financial statements included in filings with the Commission be certified by an independent accountant who has undergone a peer review of his/her accounting and auditing practice within the last three years.

Since its inception in 1978, our Board has had the unique opportunity of assessing the effects and effectiveness of the peer review process by virtue of monitoring the self-regulatory program of the SEC Practice Section of the American Institute of Certified Public Accountants. We have, in each of our eight annual reports, unequivocally stated that the peer review process has improved the quality of audit practice of the Section's member firms.

Peer review is the most effective means available to a profession to improve and maintain the quality of service that its members provide. Our extensive involvement with the program of the SEC Practice Section has convinced us that it works and works well at reasonable cost. SECPS member firms of all sizes, from the largest to the smallest, have concluded that peer review has a positive cost/benefit relationship and have heartily endorsed the program.

Thus, our Board strongly believes that the public interest would be best served if all auditors, especially those of public companies, were required to undergo peer review periodically and to make the improvements in their quality control systems that a qualified peer reviewer considered necessary for the firm to have reasonable assurance of complying with professional standards in performing accounting and auditing engagements. We have consistently urged members of the profession to make this commitment voluntarily. We had hoped that the recent proposal of the AICPA Board of Directors and Council would be adopted, which for practical purposes would have caused virtually all firms with public clients to join the SEC Practice Section and thus would have helped accomplish this goal. Although the proposal received a 61-percent favorable vote, we were disappointed that it did not obtain the two-thirds margin necessary for adoption.

Our Board unequivocally endorses the objective of the Commission's mandatory peer review proposal, namely, "to enhance the quality of audits of Commission registrants." However, we are concerned that the SECPS program, which has functioned exceedingly well as an initiative of the profession subject to oversight by our Board and your staff, might be less effective if some of the rigid rules in the proposal were adopted and literally enforced.

Our major concerns relate to:

- The role of the SEC
- The need for confidentiality
- The setting of peer review standards
- The review of contested audits

The Role of the SEC

The public accounting profession is effectively regulated at three distinct levels—by firms, by the profession, and by government. While the objective of each level is to assure reliable financial reporting, each achieves its objective in a different way.

While we applaud the objective of the SEC's current proposal, we believe the proposal should be revised so that it will not materially alter the present relationship between the accounting profession's peer regulators and government regulators, a relationship which has in the past decade developed and matured, we believe, in a manner satisfactory to everyone involved.

We therefore urge the Commission to make clear that the Commission's relationship to a qualifying peer review organization (PRO) will be to test the effectiveness of the PRO's system of peer review, including the role of its oversight body. Thus, each PRO should be allowed the same degree of autonomy that the SEC Practice Section now enjoys. Experience with the SEC Practice Section's program shows that the SEC does not need to have access to all peer reviews administered by the PRO or to the complete set of workpapers prepared by peer reviewers, as the proposal suggests. The Commission has been able to satisfy itself as to the effectiveness of the SECPS's peer review program by inspecting selected workpapers of fewer than 25 percent of the reviews performed in recent years. Indeed, the SEC's discussion of the proposed rules acknowledges that "the private sector approach currently embodied in the SECPS and POB structure has proved both effective and efficient."

The background section of the proposal states: "Just as the Commission's previous conclusions concerning the efficacy of the SECPS's program have been reached without the review of all peer review workpapers, it would usually not be necessary for the Commission to review all peer review workpapers to judge the efficacy of a PRO's program or its compliance with the Commission's requirements." The proposed rules, however, establish the Commission's right to access all peer review workpapers but fail to support why that ever would be necessary for the SEC to satisfy itself that the program of a PRO is functioning properly.

The Board urges the Commission to extend to all PROs the principle of testing the system that has

worked so well with its oversight of the peer review program of the SECPS. Moreover, rather than the rigid structure proposed in the rules, the Board suggests that the Commission enter into a memorandum of understanding with each qualifying PRO, which should be available for public scrutiny, with provisions similar to those included in the October 15, 1982 Memorandum of Understanding among the SEC, SECPS, and the POB. Such a document should contain provisions similar to those in that memorandum, such as:

- Establishment of the SEC's right to inspect selected peer review workpapers of firms auditing SEC registrants and the workpapers of the oversight body.
- Formalization of the timing of availability of workpapers and reports.
- Provision for confidentiality of certain data, such as names of SEC registrants, personnel and offices of reviewed firms, etc.

The Board agrees that a PRO should report immediately to the Office of the Chief Accountant whenever a reviewed firm has a material quality control deficiency and refuses to take corrective action. Based on our oversight of the SECPS peer review program, we are confident that this will rarely, if ever, be necessary. Over the ten years during which the AICPA program has been in existence, only one firm refused to take the corrective action considered necessary by the Section for the firm to have reasonable assurance of complying with professional standards when performing accounting and auditing engagements; that firm was expelled. However, should such a situation eventuate in the future, the Board believes that denial of the right of that auditor to certify financial statements filed with the Commission would be appropriate.

The Board believes the SEC's relationship with the program of the SEC Practice Section is consistent with the notion of self-regulation which the SEC has publicly supported. Moreover, such an approach is the only one that is likely to assure the high degree of voluntary cooperation of firms that the Board believes is essential for the operation of an effective peer review program by a PRO.

The Need for Confidentiality

We believe one of the major reasons that the peer review and special review programs of the SECPS are effective is because they have evolved into programs that strike a proper balance between protection of the public and the rights and obligations of the member firms. The confidential relationship auditors have with their clients is essential for an effective audit process; such a relationship is also essential for an effective peer review process. The SECPS's peer review process works well because it protects this confidentiality. Peer review workpapers made available to the staff of the Office of the Chief Accountant do not identify SEC registrants (or even the nonpublic clients), offices of multi-office firms, individuals within firms except by title or position,

or firms that audit fewer than ten SEC registrants. If these features are not retained, we sincerely believe the peer review process would be considerably less effective; the reviewed firms would be less candid in responding to questions posed by the peer reviewers, and peer reviewers would be less inclined to document detailed findings in peer review workpapers. Both these elements are essential for effective monitoring of the program by the PRO's peer review committee, its oversight board, and the staff of the SEC.

The Setting of Peer Review Standards

If the proposal is adopted in its present form, the SEC would establish peer review standards that PROs would be expected to follow. However, we believe that the Commission should look to the private sector to establish quality control and peer review standards, in much the same way as the Commission looks to the private sector to establish accounting and auditing standards. Moreover, a relatively high degree of flexibility is needed if rules are to be promptly adapted to a changing environment; such flexibility is more easily attainable if standards are set by a PRO than through the rule-making procedures of the Commission.

The standards for performing and reporting the results of peer reviews are not static. The standards of the SECPS have been repeatedly revised as experience has indicated the need for or the possibility of improvement. At times, standards were revised solely at the initiative of the Section, at other times at the urging of the Board or the SEC.

The setting of standards or rules by the SEC would materially alter the environment and stifle the profession's initiative to make changes. Therefore, we urge the Commission not to publish peer review rules, but instead (a) to publish guidance for a PRO to follow in setting standards it expects its reviewers and members to follow, and (b) to require a PRO in order to be recognized as a qualifying PRO to establish and enforce peer review standards that are acceptable to the Commission.

If the SEC adopts rules as proposed, the Commission would have line responsibility and control over each PRO and its board. We do not believe that this would be in the best interests of the profession, the public, or the SEC. We do not believe that appointments of members of a PRO's oversight board should require SEC's concurrence. If this were done, the board would not be perceived as independent but rather would be seen as an arm of the Commission. Such a perception could adversely affect the working relationships that a board needs to perform its oversight role effectively. Such a change would be in sharp contrast to the efficient and effectively operative self-regulatory process that the Commission has found to be wholly satisfactory over the years in dealing with the SEC Practice Section and our Board.

We strongly believe a board should be truly independent with respect to both the profession and the Com-

mission if it is to be effective and have credibility.

The Review of Contested Audits

A peer reviewer is charged with the responsibility of reviewing each engagement selected for review in sufficient depth to be able to conclude whether the engagement was or was not performed in all material respects in accordance with professional standards. In addition, largely at our urging, peer review teams of the SEC Practice Section are required to consider all litigation, proceedings, or investigations involving SEC registrants initiated since the firm's prior peer review in setting the scope of that firm's peer review—in deciding which offices, audit areas, clients in specified industries, and engagement personnel are to be subjected to review.

However, while we believe it is entirely appropriate that peer review teams judge each engagement reviewed as to whether it was performed in accordance with professional standards, we believe it is inappropriate to require such judgment to be made concerning the performance of an audit that is being litigated. The judicial process, which has access to all relevant facts through its subpoena powers and safeguards the rights of both plaintiff and defendant, is the only appropriate forum where contested audits should be resolved. Consequently, we believe that the right of a firm to deny full access to contested audits, to either a peer reviewer or a special investigator outside the judicial process, is reasonable in the light of the insurance crisis, the litigious climate, the high cost in terms of time and money in defending oneself in a court trial or government proceeding, and the magnitude of monetary damages against auditors awarded by some judges and juries.

Nevertheless, our Board believes that a PRO should have a program to deal with the quality control implications of contested audits. We believe that this should be a separate supplemental program and not an integral part of the peer review program. The consideration of contested audits by a PRO in a special investigative process rather than the peer review process has several advantages:

- Quality control deficiencies that may be inferred from allegations of contested audits would receive immediate attention rather than be deferred until that firm's next peer review, which could in some cases be in excess of two years later.
- A standing committee of highly experienced practitioners is more likely to be objective in evaluating the quality control implications of the allegations made in litigation than a review team that may have previously opined on the quality controls of the firm.

- A standing committee that reviews all contested audits of all member firms belonging to a PRO is better able to assess whether professional standards should be reevaluated or whether professional guidance in the application of standards is adequate.

The objective of the special review program of a PRO should not be to determine whether a contested audit has or has not been performed in accordance with professional standards. Consequently, we believe that those charged with the responsibility for the special investigative program should not and need not have access to the full set of workpapers of contested audits. We support the concept that "special investigators," when appropriate, should be expected to request and be given access to documentation that will permit them to make a judgment quickly and efficiently as to whether a firm's quality control system is appropriately designed and is being complied with.

We recognize, however, that in rare cases, where the potential monetary damages are relatively large, a firm may not want to risk granting access to even a portion of the workpapers prepared during the course of performing a contested audit. In such cases, it is expected that refusal by a firm to grant access to the requested documentation will materially increase the likelihood that the special investigators may need to order a special review in order to gain the requisite assurance that the firm's quality control system provides it with reasonable assurance of complying with professional standards in the performance of future engagements.

The Board believes that the four-phased approach for the operation of the special investigative or review process recently recommended by the SECPS Task Force on SIC Methodology and adopted in April 1987 by the Section is an appropriate model for the special review process of a PRO. We recommend that the SEC require each qualifying PRO to have a similar process.

In conclusion, we strongly favor mandatory peer review for an auditor of an SEC registrant rather than proxy statement disclosure by the registrant as to whether its auditor has subjected his/her quality control system to peer review. Should the Commission decide not to require auditors of SEC registrants to belong to a PRO acceptable to the Commission, the Board would support such a disclosure requirement.

We shall be pleased to meet with the Commission to clarify any of the matters discussed in this letter.

June 29, 1987

Exhibit II

POB Comment Letter on Draft Report of National Commission on Fraudulent Financial Reporting

The Public Oversight Board is pleased to comment on the Commission's draft report entitled *Report of the National Commission on Fraudulent Financial Reporting*. While our paramount responsibility is to oversee the voluntary self-regulatory programs of the SEC Practice Section of the AICPA, we have a keen interest in all initiatives to improve the quality of audit practice and financial reporting.

We applaud the Commission's diligent and practical consideration of the complex issues of fraudulent financial reporting. We generally support all of the Commission's recommendations and appreciate the fact that the report incorporates the views we expressed in our meeting with the Commission.

From its inception in 1978, the Board has had a unique opportunity to assess the effects of the self-regulatory programs of the SEC Practice Section on quality of audit practice. While the individual members of the Board may wish to submit personal comments on other aspects of the draft report, this commentary will be limited to those aspects of the report that directly or indirectly bear on the accounting profession's self-regulatory program:

- Improving Audit Quality
- Concurring Partner Review
- Peer Review
- Regulation of the Public Accounting Profession
- Role of the Audit Committee vis-a-vis Management Advisory Services by Auditors

Improving Audit Quality

Our Board agrees that elimination of fraudulent financial reporting requires concerted action of all parties involved in the financial reporting process and that the roles of the reporting entity and the audit committee are crucial. The auditing profession also has an important role to play, and, in our view, has not thus far accepted the degree of responsibility that it should have for requiring that the scope of an audit be expanded to detect instances of fraudulent financial reporting not accompanied by collusive acts of management and/or employees.

We are pleased to note the profession's current initiatives in this regard. Adoption of the revisions to auditing standards currently being proposed by the Auditing Standards Board will require auditors to expand the scope of the audit to increase the likelihood of detecting major errors and irregularities and to evaluate the effectiveness of the client's internal controls.

Concurring Partner Review

The Board believes that review of an audit engagement by a partner in addition to the engagement partner can provide a firm with significant additional assurance that its engagements are performed in all material respects in accordance with profes-

sional standards. It should be noted, however, that concurring partner review is now required only for audits of SEC registrants performed by firms that are members of the SEC Practice Section. Neither generally accepted auditing standards nor quality control standards require that audits be subjected to concurring partner review. Moreover, the concurring partner review membership requirement has only recently been strengthened by the SEC Practice Section—in large part at our urging—to require that certain workpapers as well as the audit report and financial statements be subjected to review by the second partner. The effectiveness of the implementation of the expanded requirement will be first tested in peer reviews conducted in 1987.

A meeting in May 1987 with representatives of the Section's Peer Review and Special Investigations Committees disclosed differences among CPA firms as to additional assurance that a concurring partner review can and should provide and the responsibility that the concurring reviewer is or should be assigned. We were advised that such differences exist even among the large national firms and that very few firms charge a concurring reviewer with the responsibility for doing a sufficiently comprehensive review so as to provide the firm with additional assurance that the audit was conducted in a manner that would reasonably ensure detection of fraudulent financial reporting.

The Board is concerned about the differences that exist regarding the degree of assurance that a concurring partner review should provide. We are aware, however, of the difficulty of specifying procedures that all firms should require of their concurring review partners in view of the widely varying methods firms use in documenting the results of auditing procedures performed.

The Board believes the Commission's recommendations regarding concurring review have merit and should be required to be applied by all auditing firms, at minimum to audits of clients of public companies or of clients in high-risk industries. The Commission might well consider recommending that the Auditing Standards Board incorporate concurring partner review as part of quality control standards or, at minimum, issue guidance as to when an audit engagement should be subjected to concurring review.

Peer Review

Peer review, the keystone of the accounting profession's self-regulatory program, has undeniably improved the quality of audit practice and is the most effective means available to the accounting profession to improve the quality of service that its members provide.

The Section has revised its peer review program

whenever experience indicated the need for or a possibility of improvement. One such recent revision will cause reviewers to (a) obtain a list of SEC engagements accepted since the last peer review where, as reported in a Form 8-K or similar public filing, the former auditor resigned or there was a disagreement on a reporting matter between management and the auditor, and (b) ascertain whether the firm rendered an opinion on the application of generally accepted accounting principles prior to accepting the registrant as an audit client and, if so, whether such opinion was issued in accordance with the firm's procedures.

In addition, peer reviewers are required to review current and prior period workpapers to the extent necessary to evaluate whether any matters which led to resignation of the predecessor auditor or which were the subject of disagreement between the predecessor auditor and management were handled appropriately by the successor auditor. We believe these procedures will be effective in detecting situations where the successor auditor accommodated "an opinion shopper." We are satisfied that compliance with the recently adopted auditing standard regarding opinion shopping can be adequately tested in the peer review process. Therefore, we do not consider it necessary that peer reviewers be required to review all new client engagements.

Regulation of the Public Accounting Profession

Our Board strongly believes that the public interest would be best served if all auditors, especially those of public companies, were required to undergo peer review periodically and to make those improvements in their quality control systems considered necessary to provide reasonable assurance of complying with professional standards in performing accounting and auditing engagements. Accordingly, we endorse the current proposal of the Securities and Exchange Commission that each registrant's financial statements be audited by an auditor that belongs to a peer review organization acceptable to the SEC. Our Board supports denial of an auditor's right to certify financial statements filed with the Commission if his/her firm has a material quality control deficiency and refuses to take corrective action.

However, we are concerned that the peer review program of the SEC Practice Section, which has functioned exceedingly well as an initiative of the profession and is subject to effective oversight by our Board and the SEC, might be less effective if the rigid rules in the SEC's proposal were adopted and strictly enforced. Our Board believes the SEC's present relationship with the SEC Practice Section is consistent with the notion of self-regulation which your Commission embraces and the SEC has publicly supported. Moreover, the present approach will continue to assure the high degree of cooperation by firms that the Board believes is essential for the operation of an effective peer review program. The SEC should not have the right to exercise line

authority over any peer review organization; its role should be one of active oversight. As your Commission recommends, we fully agree that "...the SEC should continue to monitor and maintain liaisons with the public accounting profession's quality assurance program."

We have expressed these views to the Securities and Exchange Commission. A copy of our letter to the Commission is attached for your consideration.

Role of the Audit Committee Vis-a-vis Management Advisory Services by Auditors

In November 1986, our Board published results of a survey it authorized a professional research organization to conduct entitled, *Public Perceptions of Management Advisory Services Performed by CPA Firms for Audit Clients*. While no instance of impaired auditor independence or objectivity attributable to the rendition of advisory services has ever come to our attention, the Board authorized the research study because it is concerned that the continuous expansion of consulting services by CPA firms may be perceived as impairing auditor independence and thus could adversely affect the value of the audit function over time.

The survey indicated that key public groups perceive certain types of MAS as impairing auditor objectivity and independence. In distributing the research report, the Board noted that the survey was not authorized or intended to be used as a basis for FOB action. It was intended to be used by the profession to decide what action, if any, the profession should take to change the perceptions of various groups which either use audited financial statements or have a high interest and concern with them. The Board is pleased to note that the SEC Practice Section has formed a task force to consider the implications of the perceptions reported in the Board's survey.

We also intend to suggest in our upcoming annual report that the information contained in the research report be used by firms in developing policies for the rendition of advisory services and to companies in dealing with these matters. In that regard, we support the Commission's recommendation that an audit committee should adopt a policy of reviewing management's evaluation of factors related to the independence of the company's auditor and approving in advance the types and extent of management advisory services that management plans to engage the company's auditing firm to perform.

Our Board commends the Commission for its thorough investigation of the nature and causes of fraudulent financial reporting and its meaningful recommendations for eliminating, or at minimum significantly reducing, the incidence of fraudulent financial reporting. We shall be pleased to meet with the Commission to clarify any of the matters discussed in this letter.

June 30, 1987

Appendices

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Appendix A

Peer Review Activities

The quality of services of a CPA firm is dependent in large part on its system of quality control. In 1979, the American Institute of Certified Public Accountants issued quality control standards applicable to the conduct of an accounting and auditing practice. Each firm that is a member of the Division for CPA Firms is required to establish quality control policies and procedures that provide the firm with reasonable assurance that its accounting and auditing engagements will be performed in accordance with professional standards—i.e., generally accepted accounting principles and generally accepted auditing standards.

While generally accepted auditing standards relate to the conduct of individual audit engagements, quality control standards relate to the conduct of a firm's audit practice as a whole. A system of quality control for a CPA firm consists of nine elements: independence, acceptance and continuance of clients, hiring, assignment of personnel to engagements, supervision, consultation, professional development, advancement, and inspection.

Peer review—the cornerstone of the accounting profession's self-regulatory program—is the process by which the design of and compliance with a CPA firm's quality control system for its accounting and auditing practice is examined, evaluated, and publicly reported on, by a team of qualified, experienced, and independent CPAs from one or more other firms. Firms that are members of the Division for CPA Firms must undergo a peer review of their accounting and auditing practice at least once every three years.¹ This discussion, however, is limited to the peer review program of the SEC Practice Section.

A peer review consists of the following:

- An evaluation of the appropriateness of the design of the firm's quality control system in the light of the firm's accounting and auditing practice.
- A variety of tests for compliance by its personnel with the firm's quality control policies and procedures at each organizational or functional level within the firm.
- Review of a representative sample of accounting and audit engagements, including audit and other reports, financial statements, and relevant workpaper files to ascertain whether they were performed or prepared in conformity with professional standards and the firm's policies and procedures.
- Tests for compliance with other membership requirements of the Section, some of which are mandatory quality control policies and procedures above and beyond current professional standards.

- Expression of a written opinion on the design of the firm's quality control system and the level of compliance by the firm's personnel with its quality control policies and procedures and the Section's membership requirements.

The Section has developed and published standards and extensive guidance to assist review teams in conducting and reporting on peer reviews.

1986 Reviews

In 1986, 127 SECPS member firms had their quality control systems peer reviewed—14 for the first time, 18 for the second time, 93 for the third time, and 2 for the fourth time.

Six of these were "accelerated reviews"—i.e., reviews the Peer Review Committee required the firms to undergo prior to the expiration of the normal three-year cycle because their prior review had disclosed significant quality control deficiencies requiring extensive corrective actions. All six firms had previously received modified reports. Four of the firms received unqualified reports on their 1986 reviews. Two firms received another modified report because their quality control systems still needed significant improvement.

As of June 30, 1987, the Peer Review Committee had accepted 111 reports on member firms' 1986 peer reviews. Acceptance of reports on the remaining 16 reviews had been deferred pending resolution of various significant matters.

Types of Reports Issued

After performing its review of the firm's quality control system and testing compliance by firm personnel with that system and with the Section's membership requirements, a peer review team summarizes its findings and conclusions in a formal report, usually accompanied by a letter of comments. The review team may express an unqualified, qualified, or adverse opinion on the reviewed firm's quality control system. Strict adherence to the reporting standards delineated in the SECPS Manual is enforced by the Section's Peer Review Committee.

In 1986, 115 or 91% of the firms reviewed received unqualified opinions, 105 of which were accompanied by letters of comments. Twelve firms, or 9%, received qualified reports and letters of comments. Reports on reviews completed in 1986 are classified by type of report accepted by the Peer Review Committee or, for the 16 reports not yet processed by the Committee, based on a preliminary evaluation made by the Committee's and POB's staffs of the peer review teams' findings. Since inception of the program, about 950 SECPS peer reviews have been performed; 88% of the reports issued have been unqualified, 10% qualified, and 2% adverse.

While improvement in the quality of accounting and auditing of member firms cannot be precisely measured, it is clear that improvement is occurring. See discussion of "Improvements in Quality of Practice" on page 12 of the Board's report.

The Committee and its staff continue to enforce peer review standards vigorously and equitably, often not accepting the review team's report as originally submitted. In 1986, the Committee initially rejected 19 reports—15% of the total. The primary reasons for rejection were:

- The report and/or letter of comments issued were not appropriate in light of the deficiencies noted during the review; in these cases, the review teams were required to change the report and/or letter of comments.
- The review team did not test a representative or sufficient number of accounting and auditing engagements; in these cases, review teams were required to return to the firm and review additional engagements.
- Major disagreements between the review team and reviewed firm had not been resolved; in these cases, a Committee member was appointed to review the findings, discuss the matter with both parties, and recommend a course of action to the Committee. In each case, the matter was ultimately resolved to the satisfaction of all parties.

statements to be corrected in subsequent year by restating the prior year, (c) perform the additional audit procedures considered necessary by generally accepted auditing standards, or (d) eliminate cause of impairment of independence.

If the firm does not concur with the review team's opinion that the engagement is substandard, the matter is reported immediately to the Committee for resolution. If the firm and the Committee cannot resolve the matter to their mutual satisfaction, the firm is required to report the matter to the Professional Ethics Division for resolution and to advise the Committee of the actions taken as a result thereof.

The number of engagements evaluated by review teams as substandard has decreased in each of the past three years, another indication that the process is improving the quality of practice of the member firms. Details are shown in the accompanying table.

During 1986, review teams reviewed the reports, financial statements, and supporting workpapers of 1,285 audit engagements, 327 of which were audits of SEC registrants. Review teams found 12 engage-

Audit Engagements Evaluated as Substandard by Peer Review Teams

	<i>Peer Review Year</i>			
	1983	1984	1985	1986
Number of Firms Reviewed	144	167	80	127
Number of Audit Engagements Reviewed	1315	1162	657	1285
Number of Engagements Evaluated as Substandard	33	19	5	12
Percent of Audit Engagements Reviewed and Evaluated as Substandard	2.5%	1.6%	0.8%	0.9%
Number of Firms Performing Engagements Considered Substandard	16	10	4	10

Substandard Performance on Individual Engagements

Peer review teams assess the workpaper evidence for each engagement reviewed to ascertain whether the engagement was performed in conformity with professional standards. An engagement is considered substandard when, in the opinion of the review team, the financial statements were incorrectly reported to be in conformity with generally accepted accounting principles in all material respects, or when the auditing firm had not performed sufficient procedures to support the opinion it expressed.

Each substandard engagement discovered in the course of a review is required to be reported to an appropriate authority within the reviewed firm and addressed by the firm immediately.

If the firm agrees with the review team's conclusion, it is required to (a) withdraw its opinion if the financial statements are considered not to have been prepared in accordance with generally accepted accounting principles, (b) cause financial

engagements, or 0.9% of the number reviewed, that they considered to be substandard in the application of generally accepted accounting principles or generally accepted auditing standards; 4 were audits of SEC registrants.

Monitoring of Corrective Actions Required of Firms Reviewed in 1986

Representatives of two member firms were required to meet with the Committee to discuss the quality control deficiencies noted in their peer reviews and to report on the corrective actions they had initiated. In each case, the Committee impressed upon the firm representatives, who were either members of top management or had responsibility for the firm's quality control system, the need for strong and timely implementation of corrective action plans. In addition, one firm voluntarily met with the Committee to report the changes it had made to its quality control policies and procedures and the results obtained therefrom. The Committee is actively monitoring the results of the corrective actions of each of these firms.

Corrective Actions Required with Respect to Substandard Engagements Identified in Peer Reviews Performed in 1986

	SEC Engagements	Non-SEC Engagements
Audit report recalled and financial statements/audit report revised and reissued . . .	0	3
Financial statements corrected in subsequent year by restating the prior year	0	3
Omitted auditing procedures performed	2	2
Cause of impairment of independence eliminated	2	0

In each instance where significant quality control deficiencies were detected during the peer review, including some not serious enough to call for a modified report, the Committee required the reviewed firm to provide assurance that an appropriate corrective action plan had been effectively implemented. Such assurance was required of 21 of the 111 firms reviewed in 1986 whose reports have been accepted by the Committee.

Assurance was requested in various forms, such as requiring a firm to:

- Undergo a full scope peer review within one year.
- Permit the team captain to evaluate revisions of the quality control system to test compliance with the revised policies and procedures to assess the effectiveness of corrective actions.
- Submit copies of the inspection report for the following year.
- Permit the team captain to review the planned scope of the firm's next inspection and monitor its performance.
- Permit the team captain to review major revisions to the firm's quality control document and report the results of such review to the Committee.
- Develop and submit copy of detailed corrective action plan and submit quarterly reports to the Committee on the status of the implementation of the plan.

Monitoring of Corrective Actions Required of Firms Reviewed in 1985

At June 30, 1986, the reports on reviews performed in 1985 of five firms had not been accepted by the Committee, pending satisfactory resolution of certain matters by the reviewed firms. All five reports have since been accepted by the Committee. The Committee required those firms with serious quality control deficiencies to provide assurance that the causes of the deficiencies had been corrected. Assurance measures included:

- Requiring one firm:
 - to submit to a full scope peer review in 1987,

- to continue to employ consultants to perform preissuance reviews of the financial statements, audit reports, and supporting workpapers on all audit engagements,
- to employ consultants to design and make operative an appropriate quality control system, and
- to submit its internal inspection reports for evaluation by the Committee.

■ Requiring one firm:

- to have its peer review team test and report on the effectiveness of selected revised quality control policies and procedures, and
- to submit its internal inspection reports for evaluation by the Committee.

■ Requiring one firm to submit its internal inspection reports for evaluation by the Committee.

Every member firm made or agreed to make the changes in its quality control system deemed necessary by the review team (and/or by the Committee) and none refused to provide the information the Committee requested evidencing that appropriate and effective corrective actions had been taken. Both small and large firms have had to provide the Committee with such evidence. At June 30, 1987, the Committee continued to monitor the effectiveness of revisions to the quality control systems of firms in the following size ranges:

Number of Professionals	Number of Firms
1 - 10	9
11 - 100	12
Over 100	5

Modification of Peer Review Standards and Procedures

Peer review standards are revised whenever experience suggests they can be made more effective or efficient or whenever additional membership requirements are enacted. During the past year, as reported on page 20 of the Board's report, standards were adopted to address concerns about "opinion shopping."

Additionally, the Committee adopted as a peer review standard a procedure that had been informally applied in prior years. Upon identification of a substandard engagement during the course of a peer review, the review team must now consider the advisability of extending the scope of the review to other engagements to determine if the substandard work is indicative of a pattern of performance or an aberration. The additional procedures could include the review of additional engagements supervised by the same partner, other engagements in the same industry, or engagements with characteristics similar to those present in the substandard engagement.

In 1986, the Peer Review Committees of both sections revised the standards for performing and reporting peer reviews, significantly revised the forms, checklists, and questionnaires used in performing peer reviews, and issued a new guide entitled "Suggestions for Writing Letters of Comments." Such guidance is expected to effect greater uniformity in both the form and content of such letters in the future. In addition, review team captains were required to attend an all-day training program involving the above changes prior to performing peer reviews after August 1, 1986. The training material focused on identifying systemic deficiencies in quality controls.

Other Activities

In November 1986, the Committee met with the SEC Chief Accountant and members of his staff to discuss the effectiveness of modifications made in the peer review program during the year.

Members of the Committee and its staff also met with representatives of the Auditing Standards Board and Financial Accounting Standards Board to discuss practice problems that review teams encountered when performing this year's peer reviews.

Monitoring of MAS Engagements

The Section's membership requirements proscribe member firms from performing certain types of management advisory services for SEC registrants whose financial statements the firm audits. Peer review teams review both the audit and MAS engagements performed for selected SEC clients to ascertain that (a) the MAS engagement was not one proscribed by the Section, (b) the firm did not impair its independence by performing the MAS engagement—i.e., by acting either in a decision-making role or as an employee—and (c) all major decisions made during the course of performing the audit were objective. Particular emphasis was placed on clients where the fees for MAS equalled or exceeded the audit fee.

No instance was uncovered of violation of membership rules or impairment of independence and objectivity.

SEC Oversight of the Process

The SEC, through the Office of the Chief Accountant, has access to a sample of randomly-selected peer review workpapers, to POB workpapers on all reviews, and to all documents in the Section's public file. This is necessary so the SEC can make an independent evaluation of the effectiveness of the process. The SEC staff has substantially completed its inspection of the 1986 reviews; however, certain reviews in its sample of review team workpapers selected are not yet avail-

able because the reports have not yet been accepted by the Committee. The SEC staff has indicated that it is satisfied with both peer review and oversight performance on the reviews inspected to date.

In its annual report for 1986, as it has done in previous years, the SEC opined favorably on the process: "The Commission believes the peer review process contributes significantly to improving the quality control systems of member firms and thus should enhance the consistency and quality of practice before the Commission."² This conviction has led the SEC to propose a rule for public comment that would require auditors who practice before the Commission to undergo triennial peer review by an approved peer review organization (PRO) or by qualified reviewers under direct SEC supervision. According to that proposal, the Section and the POB would constitute such a PRO. The SEC observed in the background text of the proposal that: "The private sector approach currently embodied in the SECPS and POB structure has proved both effective and efficient...."³

Benefits of Peer Review

Participants in the peer review program generally indicate that it is beneficial, as noted in the following news item that appeared in the June 1987 issue of the *Journal of Accountancy*:

"CPA Firms Report More Attention Paid to Quality. Of those accounting firms that are members of the Division for CPA firms of the American Institute of CPAs, 53% spend more time on quality control matters than they would if they were not required to do so in order to maintain membership, according to recent results of an AICPA survey. Of those surveyed, 94% reported that their peer review uncovered areas which they "really need to improve" and that needed changes were made. Of the respondents, 47% said that division membership can help a small firm hold existing clients and obtain new ones; 79% developed a quality control document because none previously existed; 47% sent personnel to training programs on quality control or peer review; and 64% said that a successful peer review helps in recruiting staff."

FOOTNOTES

1. The Private Companies Practice Section has a peer review program which for all intents and purposes is identical with the SEC Practice Section's program, except that it is not subject to oversight by a public board.
2. 53rd Annual Report of the U.S. Securities and Exchange Commission for the Fiscal Year Ended September 30, 1986, p. 25.
3. Securities Act of 1933 Release 6695, p. 48.

Appendix B

Special Investigative Activities

The mission of the Special Investigations Committee (SIC) formed in November 1979 is to determine whether allegations of audit failure of a publicly-held client made against an SECPS member firm indicate the need for corrected measures by the member firm, and to obtain assurance that the member firm makes any modifications considered necessary. Of equal importance is the Committee's evaluation of whether professional standards and related guidance are adequate in the light of a specific or a series of alleged audit failures. The Committee's focus is on the future; therefore, the Committee's mission is not to decide whether the audit failure alleged to have occurred has in fact occurred. Nor is it the Committee's objective to discipline a firm or specific individuals for inadequate performance on a given engagement.

Cases Reported

Member firms reported 44 cases to the SIC during the year ended June 30, 1987. In addition, the Committee reopened its files on two previously closed cases to consider whether actions taken by a regulatory agency against the firm or specified individuals had quality control implications not considered by the Committee in its initial evaluation.

In total, the Committee worked on 79 cases during the year. Task forces consisting of one or two SIC members were assigned to all cases to evaluate the quality control implications of the allegations. The files on 50 cases were closed based upon the evaluation of the information gathered by task forces and Committee staff. A case file is closed only after the task force (and Committee) has gathered and evaluated sufficient information to conclude that the firm has taken the corrective action deemed necessary by the Committee; in some cases, the Committee obtains added assurance by reviewing the results of the firm's next peer review. Files on ten of the cases were closed only after the Committee had reviewed the findings of either a special review or a peer review in which the scope and procedures for review of portions of the firm's quality control system were specified by an SIC task force.

Special Reviews

Based upon its analysis of information obtained from discussions with firm representatives and their peer reviewers, the Committee required two firms to submit to special reviews during 1986-87. Those two firms accounted for five of the ten cases referred to in the preceding paragraph.

Review of Firm A: Firm A was the subject of litigation that involved audits performed by personnel in one of its offices.

Prior to the commencement of the special review, the firm had assigned a team of competent inspectors from several other offices of the firm to perform an intensive review (inspection) of that office, which encompassed a significant number of audit engagements, including engagements performed by the engagement supervisory personnel involved in the litigation. After evaluating the findings of its inspection team, the firm took the following actions:

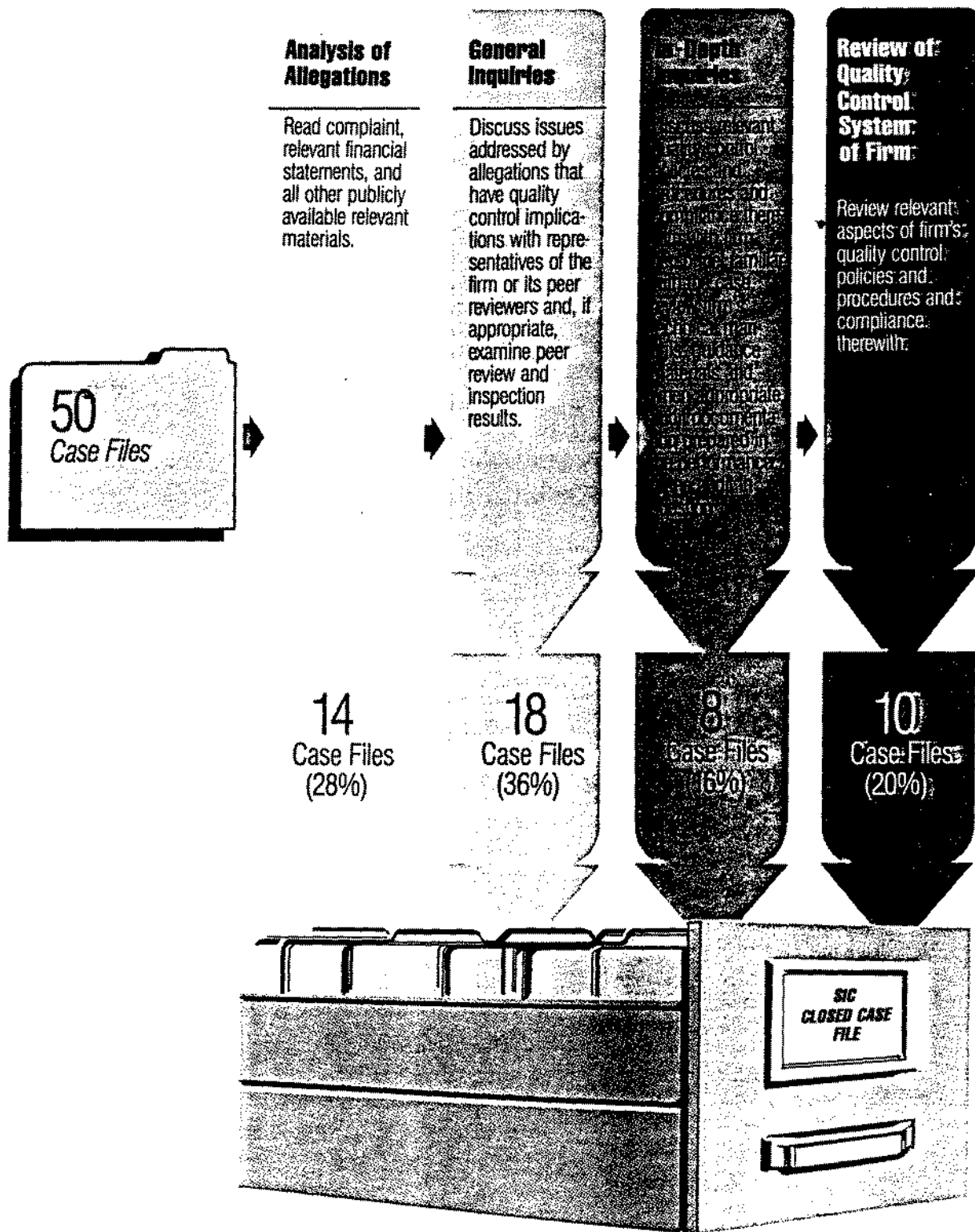
- Assigned a new director of auditing in that office.
- Reassessed the competence of a number of experienced personnel and reassigned certain audit engagement responsibilities.
- Required all audit engagements to be subjected to an additional level of review (concurring partner review).
- Required all personnel in that office to attend training programs dealing with audit work considered deficient by the inspection team.

Even though the firm reported these findings and actions to the Committee, the Committee ordered a special review by a member of the SIC.

The assigned member visited the office, interviewed key personnel, reviewed the detailed findings of the firm's inspection team and resultant corrective action plan, reviewed a sample of audit engagements performed subsequent to the implementation of the corrective actions by personnel involved in the litigation, discussed appropriate matters with firm personnel, and evaluated whether the corrective actions produced the desired results. Based upon the assigned member's conclusion that the firm had taken appropriate and effective corrective actions, the Committee closed its files on the cases involving that office of the firm.

Review of Firm B: Firm B was required to undergo a special review after the assigned SIC task force had ascertained (a) that the firm's quality control policies and procedures did not provide guidance to its personnel when using non-supervisory personnel of another firm to perform extensive auditing procedures and (b) that the firm had used personnel of other firms on several other engagements in circumstances in which the other firm was not independent.

Accordingly, by order of the Committee and under the direction and supervision of the assigned SIC task force, personnel drawn from other offices of the firm reviewed all engagements wherein non-firm personnel performed extensive audit procedures and a sample of other engagements supervised by the partner who had supervised the allegedly faulty audit. As a result of such review, the firm determined that additional auditing procedures were necessary to support the firm's opinion on the majority of these engagements. Those procedures were immediately performed.



In addition, the financial statements issued by one client and reported on by the firm were found to be in error (the error was not related to the use of non-firm personnel.) This engagement was per-

formed by an office other than the office which performed the allegedly faulty audit reported to the SIC. It was concluded that the report and financials need not be recalled since the following year's state-

ments were soon to be published and the financials of the year in question would then be restated. The firm ordered that concurring reviews be performed by partners of another office on all engagements supervised by personnel of the office which issued the erroneous report.

The firm, as a direct result of this special review, also developed and distributed a policy statement and instructions regarding assignment of audit procedures to non-firm personnel.

A member of the task force tested and evaluated the effectiveness of the firm's internal review, its findings, and corrective actions. The member reported that the firm had made appropriate changes in its quality control policy and procedures and had taken appropriate actions concerning engagements that were considered to be substandard. The Committee closed its file on the case but decided to review the results of the firm's next peer review.

Standard Review Procedures on Other Cases

For each reported case, a task force of one or two Committee members studies the complaints, relevant financial statements, and other available public documents, and considers whether allegations, if sustained, suggest a deficiency in the firm's quality control system.

As indicated, case files were closed only after special reviews had been performed; or the Committee reviewed did not lead it to conclude that the firms did not need to take corrective actions in addition to those that might have already been implemented. The diligence of the Committee in discharging its responsibilities is evidenced by the fact that its task forces held a total of 60 meetings during the year with firm representatives; the firm's peer review team captain was in attendance at 11 of these meetings.

Special Investigations Committee Activity During the Year Ending June 30, 1987

Activity Relating to Quality Control Systems of Firms Reporting Cases

Files of open cases at July 1, 1986	33
New cases reported by firms during the year	44
Case files reopened because of developments occurring after files were closed	2
Cases acted on by Committee during year	79
Case files closed after:	
Evaluation of the results of a special review or of specific procedures performed at its request in a timely review of the firm*	10
Evaluation of relevant quality control materials of the firm, such as technical manuals and guidance materials, or the results of internal reviews or inspections	26
Concluding that the allegations had no quality control implications or were based on a misunderstanding of professional standards	14
Case files closed during year	50
Files of open cases at June 30, 1987	29

Activity Relating to Review of Professional Standards

- The Auditing Standards Board was asked to address the adequacy of guidance regarding:
 - The degree to which a firm must supervise the performance of auditing procedures to be performed by personnel of another accounting firm.
 - Reliance on opinions of non-accounting specialists, especially real estate appraisers.
 - Auditing of investments in unconsolidated affiliates not separately reported on.
 - Reliability of confirmations as evidentiary matter.
 - Auditing of deferred start-up costs.
- The Accounting Standards Executive Committee was asked to review professional literature concerning:
 - Disclosures of risks and uncertainties.
 - Deferral of start-up costs.
 - Acquisition, development, and construction loans.
- The Peer Review Committee was asked to issue guidance to peer reviewers to give additional weight in selecting engagements to those where personnel of another accounting firm was used to perform substantial auditing procedures.

* The SIC frequently monitors the effectiveness of corrective actions instituted as a result of a special review by reviewing the results of the firm's next review. For example, during the year another task force evaluated the findings and reports of a peer review performed in 1986 on a firm that had a special review in 1985.

The extent of the review procedures necessary for the Committee to satisfy itself concerning the implications of a case for a firm's quality controls or for professional standards varies case by case. SIC task forces met with the engagement partners or the partners that performed a concurring review of the audit in litigation in 19 instances. In the other meetings, national office personnel familiar with the case represented the firm. The nature of matters discussed by firm representatives and task forces included but was not limited to:

- The firm's general views on the allegations and its basis for such views.
- The current responsibilities of the engagement management team and concurring partner and whether any of their responsibilities had been changed since the litigation was filed.
- The nature and timing of consultation that occurred during the performance of the engagement, if any, on the matters that were the subject of litigation.
- The current policies and procedures of the firm relative to matters that were the subject of the litigation, including technical accounting and auditing guidance materials relating to the industry.
- The results of recent peer reviews and inspections of the offices and engagement supervisory personnel involved in the litigation.
- Issues highlighted in recent peer review reports which appeared to be relevant to the allegations in the litigation.

Task forces generally requested and received from firms copies of relevant sections of their quality control policies and procedures and accounting and auditing guidance materials. In some cases, firms chose to provide documentation relevant to specific allegations to the task force even though they were not, at the time, expected to do so as a condition of SECPS membership.

The findings of the peer review of another firm, which was being monitored by the SIC, resulted in that firm installing special review procedures on all audits supervised by a partner involved in an allegedly faulty audit. The Committee closed its file on this case after obtaining assurance that the special monitoring procedures would be implemented effectively.

The accompanying chart indicates the depth of inquiry performed by task forces for the 50 cases closed by the Committee during the year.

Corrective Actions by Firms

As implied in the "Special Reviews" section, it is common for a firm which has been sued for an alleged audit failure to conduct a special internal review. Procedures in such internal review include:

- A thorough review of the engagement in question.
- A review of other engagements performed by the engagement supervisory team and the concurring reviewer.

- A review of internal firm guidance materials relating to the issues raised in the litigation.

Some internal reviews performed in 1986 were much broader in scope and encompassed a review of the structure, organization, and operations of the office in question, including how it assigns and promotes personnel and whether specified quality control policies were being complied with.

Such reviews provide the firm with a reevaluation of its performance on the engagement in question, another evaluation of the quality of work performed by personnel involved in the engagement, and additional evidence as to the effectiveness of firm-wide policies and procedures. These reviews, like peer reviews and the annual inspection program, reduce the firm's potential for future audit failure.

The results of internal reviews are confidential. However, except for the results of the review of the engagement in question which are normally legally privileged, SIC task forces have been given access to the findings of internal reviews conducted by firms when the SIC task forces have concluded that such access is desirable. In such cases, the Committee is thereby provided with documentation relevant to the competence and performance of selected supervisory personnel, the effectiveness of the firm's quality control policies and procedures, and the adequacy of the firm's accounting and auditing guidance. Therefore, the need for special review by the SIC is often, but not always, obviated.

Corrective actions taken by member firms during 1986-87, either on their own initiative or at the insistence of the Committee, included:

- Reassignment of responsibilities of certain firm personnel.
- Development and presentation of, or required participation in, specified continuing professional education programs.
- Closer supervision of work performed by specified individuals.
- Development and distribution of internal guidance materials for audits of companies in specialized industries.

Summary of SIC Activity

The SIC has two distinct responsibilities: (1) to determine whether the allegations of audit failure made against SECPS member firms indicate the need for corrective measures by those firms and (2) to determine whether an individual case (or several cases) indicates a possible need for standard-setting bodies to reconsider professional standards and related guidance materials. The activities of the Committee and the results obtained from such activities are summarized in the accompanying table.

In addition, the SIC referred two cases to the Professional Ethics Division for its review as to whether the performance of the supervisory personnel on the engagements was in accordance with professional ethical standards.

Appendix C

Executive Committee Activities

The audit process and the concomitant subject of auditors' responsibility were the focus of study by several groups, including the Section's Executive Committee, the AICPA's Auditing Standards Board, and the National Commission on Fraudulent Financial Reporting, among others.

The Executive Committee concluded that more effective communication between the auditor and the audit committee is desirable. Accordingly, the Executive Committee enacted a membership requirement to enhance audit committee-auditor communications. Member firms are now required to communicate, at least annually, the following matters to audit committees:

- Material errors or irregularities that occurred and were corrected in the period reported on and possible illegal acts insofar as those matters may bear on management integrity and the adequacy of internal controls.
- Material weaknesses in internal control which, if not eliminated, reduce the likelihood that the entity's control procedures would detect a material error or irregularity.
- Opinions on GAAP and GAAS matters sought by management from other auditors and the conclusions reached by management of the entity and the auditor with respect to matters covered by those opinions.
- Disagreements with management on significant accounting, auditing, and reporting matters which, if not satisfactorily resolved, would have resulted in qualification of the auditor's report.
- Accounting and disclosure considerations associated with significant contingencies presenting especially difficult measurement problems and which therefore are susceptible to subsequent revision.
- Accounting and disclosure considerations associated with unusual transactions which may have implications for assessing the quality of earnings.
- Adoption by management of an accounting principle if application of another applicable accounting principle would have had a materially different effect on the financials.

The Committee adopted this membership requirement even though it was aware that the Auditing Standards Board was considering incorporating such a requirement as part of generally accepted auditing standards and subsequently

issued an exposure draft of a statement on this subject. Such action by the Section is not unprecedented.

The Committee required member firms early in 1986 to establish policies and procedures concerning the expression of an opinion to nonaudit clients on the application of generally accepted accounting principles. It removed this requirement in December 1986, after the Auditing Standards Board issued an auditing standard delineating procedures all audit firms must follow in such circumstances.

In September 1986, the Committee appointed the Task Force on SIC Methodology and charged it with reviewing the objectives and operations of the Special Investigations Committee and making recommendations to enhance its effectiveness and credibility. This action was taken primarily because (1) SEC Chief Accountant Sampson had indicated that the SEC did not have sufficient access to the SIC process to permit the SEC to form an independent judgment of its effectiveness, and (2) the POB had urged that such a review be made and had proposed a more structured approach to be used by the SIC in its evaluations of the quality control implications of allegations of substandard audit performance.

The Committee accepted the task force's report at a special meeting in April 1987. The task force concluded that the mission of the SIC should not be changed; its primary objective should continue to be to complement the peer review process by evaluating the quality control implications of alleged audit failures. The Executive Committee approved and adopted five of the six recommendations advanced by the task force. The recommendations that were adopted, in summary, are:

- The SIC should adopt a more structured approach in evaluating and acting on reported cases.
- Provision is made for SIC task forces to access, when appropriate, selected documentation prepared in the course of performing the audit engagement in question.
- The SEC is to be provided more meaningful reports of the actions and findings of the SIC on reported cases.
- SIC representatives should meet periodically with the SEC Chief Accountant and members of his staff.

The Executive Committee considered a report published by the Public Oversight Board, "Public Perceptions of Management Advisory Services Performed by CPA Firms for Audit Clients," which reported the results of a survey conducted for the Board by Audits & Surveys, Inc. In light of the public perception about CPA firms performing certain types of MAS for audit clients, the Executive Committee directed its Planning Subcommittee to monitor carefully developments regarding the performance of MAS.

Appendix D

Membership Data and Requirements

One thousand seven hundred and ten firms are members of the Division for CPA Firms: 385 belong to both the SEC Practice Section and the Private Companies Practice Section, 10 belong only to the SEC Practice Section, and 1,315 belong only to the Private Companies Practice Section.

Membership in the Division increased steadily throughout the year. After considering adjustment for mergers between member firms, the number of firms in the SEC Practice Section increased during

the year by 14, and the number of firms in the Private Companies Practice Section increased by 155. Details are shown in Tables 1 and 2.

Membership Requirements

A firm that voluntarily joins the SEC Practice Section agrees to abide by the Section's stringent membership requirements which include, among others:

- Undergoing an independent triennial review of its quality control system.
- Rotating the partner-in-charge of each audit of an SEC registrant at least every seven years.
- Requiring review by a second partner, in addition to the engagement partner, of the audit report, financial statements, and selected workpapers of the audit of each SEC registrant.

TABLE 1 Analysis of Membership in the Division for CPA Firms by Number of SEC Clients and by Section—July 1, 1986 to June 30, 1987

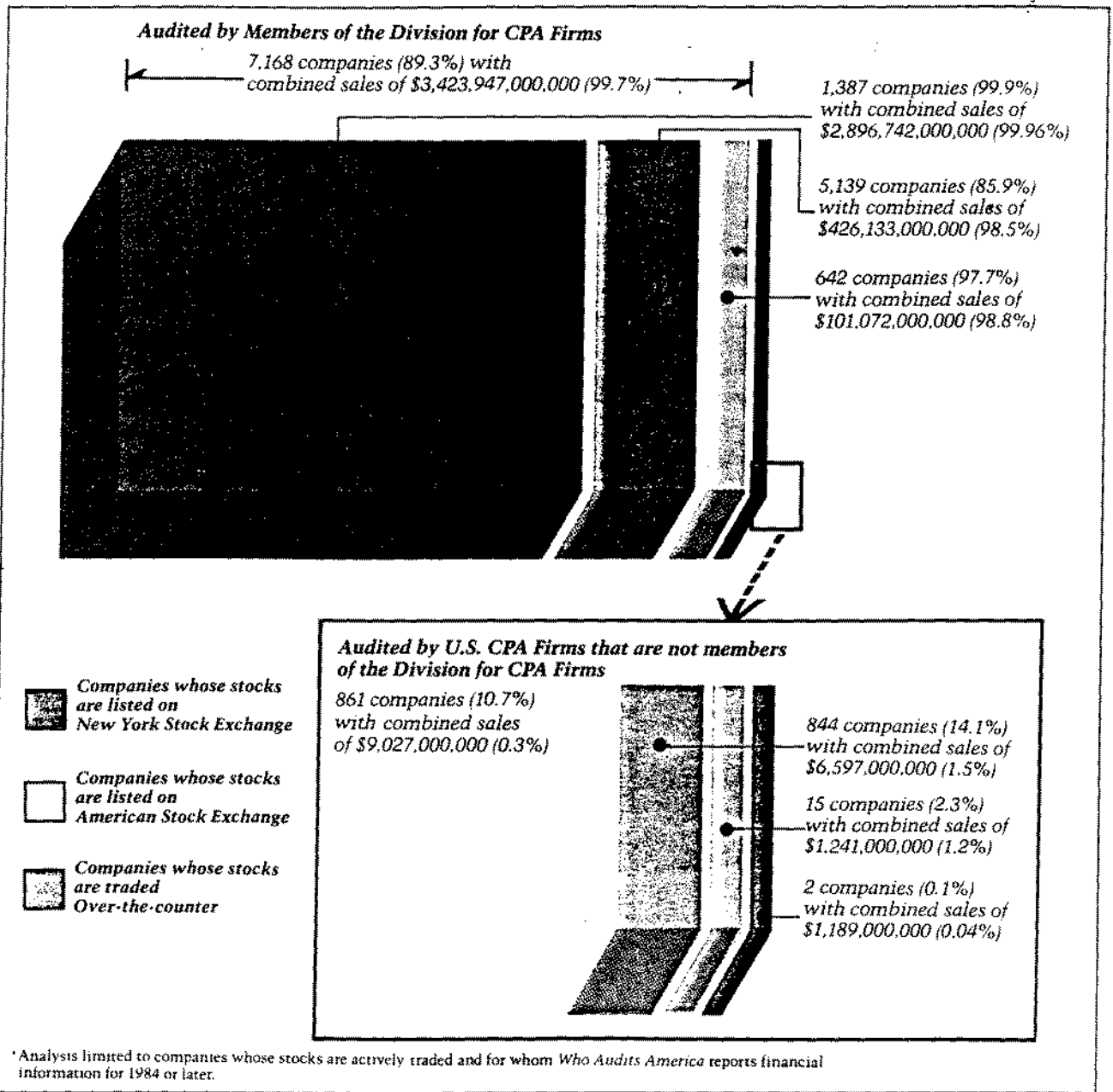
Number of Firms	July 1, 1986	Mergers* July 1, 1986 to June 30, 1987	July 1, 1986 Restated	New Members	Net Intra- Division Changes	Resignations, Terminations, Suspended Memberships	Classification Changes	June 30, 1987
Firms with one or more SEC clients								
SECPS-only	4	—	4	3	1	<1>	—	7
Both sections	174	5	169	8	9	<6>	<5>	175
PCPS-only	122	3	119	20	<9>	<5>	<9>	116
Totals	300	8	292	31	1	<12>	<14>	298
Firms with no SEC clients								
SECPS-only	4	—	4	—	—	<1>	—	3
Both sections	209	5	204	16	<6>	<9>	5	210
PCPS-only	1,061	8	1,053	209	5	<77>	9	1,199
Totals	1,274	13	1,261	225	<1>	<87>	14	1,412
All firms								
SECPS-only	8	—	8	3	1	<2>	—	10
Both sections	383	10	373	24	3	<15>	—	385
PCPS-only	1,183	11	1,172	229	<4>	<82>	—	1,315
Totals	1,574	21	1,553	256	—	<99>	—	1,710

* All 10 firms that were members of both sections merged with other firms that are members of both sections. Of the 11 PCPS-only firms that merged, 9 merged with firms that are members of both sections and 2 merged with other PCPS-only members.

TABLE 2 Analysis of Membership in the Division for CPA Firms—July 1, 1986 to June 30, 1987

	Division for CPA Firms			SEC Practice Section		
	July 1, 1986	June 30, 1987	Increase	July 1, 1986	June 30, 1987	Increase <Decrease>
No. of firms	1,553*	1,710	157	381*	395	14
No. of SEC audit clients . .	13,326	14,357	1,031	13,118	14,155	1,037
No. of practice units	3,731	3,863	132	2,019	1,946	<73>
No. of professionals	113,551	118,097	4,546	97,180	99,847	2,667

* Restated for mergers between member firms July 1, 1986 to June 30, 1987.



- Reporting specified information to audit committees of SEC clients.
- Reporting litigation alleging failure to conduct an audit of an SEC registrant in accordance with professional standards.
- Refraining from providing specified consulting services to SEC audit clients.
- Requiring all professionals in the firm to take part in prescribed levels of qualifying continuing professional education.

Auditors of Publicly-traded Companies

Firms that are members of the Division serve as

auditors for the overwhelming majority of companies whose stocks are publicly-traded.

An analysis prepared by the Public Oversight Board of companies listed in the sixteenth edition of *Who Audits America* and for whom *Who Audits America* had financial statements dated 1984 or later reveals that 89.3% of the companies are audited by member firms and that the sales of those companies account for over 99% of the aggregate sales volume of all publicly-traded companies. The majority of these companies are audited by firms that belong to the SEC Practice Section. All but two companies whose stocks are listed on the New York Stock Exchange are audited by members of the SEC

Practice Section, and all but 15 companies whose stocks are listed on the American Stock Exchange are audited by members of the Division. Details are shown in the accompanying chart.

MAS Engagements for SEC Audit Clients

Member firms are required to report certain information regarding fees received for management advisory services engagements, including MAS fees

received from SEC registrants for whom the firm also serves as auditor. Such information is reported in the firm's annual report to the AICPA which is placed in a public file. Analysis of the data reveals that in 1986 member firms performed no MAS engagements for 79.8% of their SEC registrant audit clients and that MAS fees were greater than audit fees in less than 1% of the cases. Details are shown in Table 3.

TABLE 3 Analysis of Ratio of MAS Fees to Audit Fees Received from SEC Registrants

Number of Firms Classified by Number of SEC Clients	Number of SEC Audit Clients Classified by Percent of MAS Fee to Audit Fee					Total
	0%	1-25%	26-50%	51-100%	over 100%	
Firms (12) with 100 or more SEC audit clients ..	10,567	2,094	254	199	114	13,228
Firms (11) with 20 to 99 SEC audit clients	393	35	5	5	4	442
Firms (159) with fewer than 20 SEC audit clients	345	130	8	4	0	487
Totals	11,305	2,259	267	208	118	14,157
Percents	79.8%	16.0%	1.9%	1.5%	0.8%	100.0%