Attachment

CALIFORNIA BOARD OF ACCOUNTANCY

PEER REVIEW OVERSIGHT COMMITTEE

2014 Annual Report

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I. Message from the Committee Chair

I am pleased to present the California Board of Accountancy (CBA) with the Peer Review Oversight Committee's (PROC) 2014 Annual Report. I would like to extend my sincerest appreciation to Nancy Corrigan, CPA, who served as the PROC's first-ever chair. Under Ms. Corrigan's leadership, coupled with the PROC members' unparalleled dedication, California's PROC grew from a start-up committee looking to establish best practice and protocols, to a nationally recognized leader in performing regulatory oversight of the peer review process.

The most recent recognition came when the National Association of State Boards of Accountancy's (NASBA) Compliance Assurance Committee (CAC) hosted its first inaugural open conference call for all board of accountancy peer review oversight committee members, board members, and staff which was initiated at the request of the California PROC. NASBA's CAC has agreed to continue to facilitate and host these calls twice a year in May and November.

The PROC continues to maintain an active presence on both a state and national level. The PROC participated in various American Institute of CPAs Peer Review Board conference calls that have allowed it to stay abreast of various relevant issues confronting the peer review process. And, as always, the PROC conducted its annual review of the California Society of CPAs, the administering entity responsible for administering the vast majority of peer reviews for California-licensed accounting firms.

I would like to thank the CBA for the opportunity to succeed Ms. Corrigan as Chair of the PROC. I look forward to another successful year and the opportunity to serve the CBA together with the highly qualified members of the PROC and CBA staff.

Respectfully,

Robert Lee, CPA
PROC Chair

II. Background

In 2009, the CBA sponsored Assembly Bill (AB) 138 (Chapter 312, Statutes of 2009) implementing mandatory peer review. AB 138 was signed by Governor Arnold Schwarzenegger and became effective on January 1, 2010. AB 138 requires all California-licensed firms, including sole proprietorships, providing accounting and auditing services, to undergo a peer review once every three years as a condition of license renewal. Effective January 1, 2012, Senate Bill 543 (Chapter 448, Statutes of 2011) removed the sunset language included in the original enabling legislation, making mandatory peer review permanent in California. Peer review, as defined by Business and Professions Code (BPC) section 5076(b)(1), is a study, appraisal, or review conducted in accordance with professional standards of the professional

work of a firm, and may include an evaluation of other factors in accordance with the requirements specified by the board in regulations. The peer review report shall be issued by an individual who has a valid and current license, certificate, or permit to practice public accountancy from this state or another state and is unaffiliated with the firm being reviewed.

III. PROC Responsibilities

The PROC derives its authority from BPC section 5076.1. The purpose of the PROC is to provide recommendations to the CBA on any matter upon which it is authorized to act to ensure the effectiveness of mandatory peer review.

The roles and responsibilities of the PROC, as defined by the CBA, are:

- Hold meetings as necessary in order to conduct business and report to the CBA regarding the effectiveness of mandatory peer review.
- Ensure that Board-recognized peer review program providers (Provider) administer peer reviews in accordance with the standards set forth in Title 16, California Code of Regulations (CCR) section 48:
  - Conduct an annual administrative site visit.
  - Attend peer review board meetings, as necessary but sufficient to evaluate and assess the effectiveness of the program.
  - Attend peer review committee meetings, as necessary but sufficient to evaluate and assess the effectiveness of the program.
  - Attend meetings conducted for the purposes of accepting peer review reports, as necessary but sufficient to evaluate and assess the effectiveness of the program.
  - Conduct reviews of peer review reports on a sample basis.
  - Attend, on a regular basis, peer reviewer training courses.
- Evaluate any *Application to Become A Board-recognized Peer Review Provider* and recommend approval or denial to the CBA.
- Refer to the CBA any Provider that fails to respond to any request.
- Collect and analyze statistical monitoring and reporting data from each Provider on an annual basis.
- Prepare an Annual Report to the CBA regarding the results of its oversight.

IV. Committee Members

The PROC is comprised of seven members, all of whom must possess and maintain a valid and active license to practice public accountancy issued by the CBA. Members are appointed to two-year terms and may serve a maximum of four consecutive terms.

On May 30, 2014, Robert Lee was appointed Chair of the PROC. Ms. McCoy served as the Vice-Chair during 2014.

Current members	Term Expiration Date	Maximum Term Date
Robert Lee, CPA, Chair	September 30, 2015	September 30, 2017
Sherry McCoy, CPA, Vice-Chair	July 31, 2015	July 31, 2017
Katherine Allanson, CPA	July 31, 2015	July 31, 2017
Nancy J. Corrigan, CPA	July 31, 2015	July 31, 2017
Jeffrey De Lyser, CPA	March 31, 2015	March 31, 2021
Seid Sadat, CPA	December 12, 2014	
Vacant		

V. Legislation and Regulations

Effective January 1, 2013, BPC section 5076 was amended to allow licensees to renew their license in an inactive status without having a peer review. A peer review is required prior to licensees converting or renewing to an active status.

Effective January 1, 2014, Title 16, CCR sections 40 and 45 were amended requiring licensees to report specific peer review information on the Peer Review Reporting Form (PR-1) at the time of license renewal. The revised language also clarifies that any accounting firm that performs specific services for the first time, whether it is newly licensed or simply new to performing those services, must complete a peer review within 18 months of the date it completes those services.

VI. Reporting Requirements

Pursuant to BPC section 5076(m)(1), on or before January 1, 2015, the CBA is required to provide the Legislature and Governor with a report regarding the peer review requirements that include, without limitation:

- The number of peer review reports completed to date and the number of substandard peer review reports which were submitted to the board.
- The number of enforcement actions that were initiated as a result of an investigation of a failed peer review report.
- The number of firms that were recommended to take corrective actions to improve their practice through the mandatory peer review process, and the number of firms that took corrective actions to improve their practice following recommendations resulting from the mandatory peer review process.
- The extent to which mandatory peer review of accounting firms enhances consumer protection.
- The cost impact on firms undergoing mandatory peer review and the cost impact of mandatory peer review on the firm's clients.
- A recommendation as to whether the mandatory peer review program should continue.
- The extent to which mandatory peer review of small firms or sole practitioners that prepare nondisclosure compiled financial statements on an other comprehensive basis of accounting enhances consumer protection.
- The impact of peer review required by this section on small firms and sole

practitioners that prepare nondisclosure compiled financial statements on an other comprehensive basis of accounting.

- The impact of peer review required by this section on small businesses, nonprofit corporations, and other entities that utilize small firms or sole practitioners for the purposes of nondisclosure compiled financial statements prepared on an other comprehensive basis of accounting.
- A recommendation as to whether the preparation of nondisclosure compiled financial statements on an other comprehensive basis of accounting should continue to be a part of the mandatory peer review program.

In keeping with its purpose, the PROC assisted the CBA in preparing the report for the Legislature and Governor. The CBA approved the report at its November 2014 meeting.

VII. Board-Recognized Peer Review Program Providers

American Institute of Certified Public Accountants (AICPA)

The AICPA Peer Review Program is currently the only Board-recognized Peer Review Program Provider. Through regulation, the CBA established that the AICPA Peer Review Program meets the standards outlined in Title 16, CCR section 48. Further, the CBA accepts all AICPA-approved entities authorized to administer the AICPA Peer Review Program.

The AICPA Peer Review Program provides for a triennial review of a firm's accounting and auditing services performed by a peer reviewer who is unaffiliated with the firm being reviewed to ensure work performed conforms to professional standards. There are two types of peer reviews. System reviews are designed for firms that perform audits or other similar engagements. Engagement reviews are for firms that do not perform audits but perform other accounting work such as compilations and/or reviews. Firms can receive a rating of pass, pass with deficiency, or fail. Firms that receive ratings of pass with deficiency or fail must perform corrective actions.

a. California Society of Certified Public Accountants (CalCPA)

CalCPA administers the AICPA Peer Review Program in California. As the administering entity, CalCPA is responsible for ensuring that peer reviews are performed in accordance with the AICPA's *Standards*. The CalCPA Peer Review Committee (PRC) monitors the administration, acceptance, and completion of peer reviews. CalCPA administers the largest portion of peer reviews to California-licensed firms.

b. National Peer Review Committee (NPRC)

The National Peer Review Committee (NPRC) administers the AICPA peer review program for firms that meet any of the following three criteria:

1. The firm is required to be registered with and subject to permanent inspection by the Public Company Accounting Oversight Board (PCAOB).
2. The firm performs engagements under PCAOB standards.
3. The firm provides quality control materials (QCM), or is affiliated with a provider of QCM, that are used by firms that it peer reviews.

The NASBA CAC provides oversight of the NPRC.

c. Other State Societies

California-licensed accountancy firms with their main office located in another state are required to have their peer review administered by AICPA's administering entity for that state. In most cases, the administering entity is the state CPA society in that state.

VIII. Activities and Accomplishments

Following are the activities and accomplishments of the PROC during 2014.

a. Administrative Functions

i. Committee Meetings

The PROC holds meetings as necessary in order to conduct business and report to the CBA regarding the effectiveness of mandatory peer review.

The PROC held the following meetings:

- January 31, 2014 – Berkeley, CA
- May 2, 2014 – Los Angeles, CA
- August 22, 2014 – Sacramento, CA
- December 10, 2014 – San Diego, CA

A representative of the PROC attended each of the six CBA meetings to report on PROC activities.

ii. Oversight Checklists

The PROC has developed oversight checklists which serve to document the members' findings and conclusions after performing specific oversight activities. The present checklists, listed on the following page, are included in the PROC Procedures Manual and additional checklists will be developed as necessary. Members submit the completed checklists to the CBA for future reference.

Present Checklists:

- Summary of Peer Review Committee Meeting
- Summary of Peer Review Subcommittee Meeting
- Summary of Administrative Site Visit
- Summary of Peer Reviewer Training Course
- Peer Review Board Meeting Checklist
- Peer Review Program Provider Checklist
- Summary of Oversight of Out-of-State Peer Review Administering Entity

New Checklist under Development:

- Summary of Compliance Assurance Committee Meeting

iii. Approval of Board-Recognized Peer Review Program Providers

At such time that the CBA receives an Application to Become a Board-recognized Peer Review Program Provider, the PROC will review the application and documentation using the Peer Review Program Provider Checklist and determine if the program meets the requirements outlined in Title 16, CCR section 48. Based on the review, the PROC will provide a recommendation to the CBA that the application be approved or denied.

iv. Withdrawal of Board Recognition of a Peer Review Program Provider

The PROC has not made any recommendations to the CBA concerning the withdrawal of Board recognition of a peer review program provider.

b. Program Oversight

The PROC is charged with providing oversight of all Board-recognized peer review program providers to ensure that peer reviews are being administered in accordance with the standards adopted by the CBA. During 2014, the PROC performed several activities to assess the effectiveness of the AICPA's Peer Review Program and its administering entities in California, the CalCPA and the NPRC.

i. AICPA

A. AICPA Peer Review Board (PRB)

The AICPA PRB is responsible for maintaining, furthering and governing the activities of the AICPA Peer Review Program, including the issuance of peer review standards, and peer review guidance, while being mindful of the profession's covenant to serve the public interest with integrity and objectivity.

During 2014, PROC members observed AICPA PRB meetings, as follows:

- January 30, 2014 – conference call
- May 13, 2014 – conference call
- August 6, 2014 – conference call
- September 30, 2014 – conference call
- November 14, 2014 – conference call

B. AICPA Peer Review Program Annual Report on Oversight

The AICPA Annual Report on Oversight provides a general overview, statistics and information, the results of the various oversight procedures performed on the AICPA Peer Review Program, and concludes on whether the objectives of the oversight process were met.

The PROC reviewed the report issued on September 27, 2013, for the calendar year 2012, at its January 2014 meeting. Based on the oversight procedures performed, the AICPA Oversight Task Force concluded that in all material respects (1) the administering entities were complying with the administrative procedures established by the Peer Review Board, (2) the reviews were being conducted and reported upon in accordance with standards, (3) the results of the reviews were being evaluated on a consistent basis by all administering entities and peer review committees, and (4) the information provided via the Internet or other media by administering entities was accurate and timely.

ii. CalCPA

A. Peer Review Committee

The CalCPA PRC is responsible for ensuring that the peer review program is performed in accordance with the standards and guidance issued by the AICPA's PRB. The CalCPA PRC meets in person twice a year. PROC members observe how the CalCPA PRC executes its duties in the meeting to determine whether or not this aspect of the peer review process is operating effectively in the State of California.

During 2014, PROC members attended each of the following CalCPA PRC meetings:

- May 22-23, 2014 – Dana Point, CA
- November 20-21, 2014 – Yountville, CA

B. Report Acceptance Body (RAB)

The CalCPA holds multiple RAB meetings per year. The RAB meetings generally occur via conference call. RAB members review and present the peer review reports subject to discussion on a general call. PROC members observe how the RAB executes its duties in the meeting to determine whether the peer review process is operating effectively in the state of California.

During 2014, PROC members observed each of the following RAB meetings via teleconference or in person:

- February 25, 2014 – conference call
- March 19, 2014 – conference call
- May 22, 2014 – in person
- September 23, 2014 – conference call
- November 20, 2014 – in person

C. Administrative Site Visit

The PROC is charged with conducting, at a minimum, an annual Administrative Site Visit of each Peer Review Program Provider to determine if the provider is administering peer reviews in accordance with the standards adopted by the CBA.

On July 29, 2014, the PROC reviewed CalCPA's administration of the AICPA's Peer Review Program as part of the oversight program for the CBA. As an administering entity, CalCPA is responsible for administering the AICPA Peer Review Program in compliance with the AICPA *Standards for Performing and Reporting on Peer Reviews*, interpretations, and other guidance established by the CBA. The PROC's responsibility is to determine whether the peer review program complies with the minimum requirements for a Peer Review Program, pursuant to Title 16, CCR, section 48.

The following procedures were performed as part of the PROC's oversight responsibilities:

- Reviewed policies and procedures utilized by CalCPA to govern its peer review program process.
- Read correspondence and other available documentation from other oversight activities performed at CalCPA.
- Reviewed the RAB assignment binder.
- Selected a sample of peer review reports and associated files for review.

- Discussed the peer review committee member and individual peer reviewer qualifications process with CalCPA personnel and selected a sample for inspection of resumes and other documentation.

D. Sample Reviews

The PROC conducts reviews of peer reviews accepted by a provider on a sample basis. The review may include, but is not limited to, the peer review report; reviewers' working papers prepared or reviewed by the provider's peer review committee in association with the acceptance of the review; and materials concerning the acceptance of the review, the imposition of required remedial or corrective actions, the monitoring procedures applied, and the results.

This oversight activity was completed on July 29, 2014, in conjunction with the Administrative Site Visit.

E. Peer Reviewer Training

The PROC is responsible for ensuring that peer review providers develop a training program designed to maintain or increase a peer reviewer's currency of knowledge related to performing and reporting on peer reviews. The CalCPA Education Foundation offers two types of peer reviewer trainings. Each year, the CalCPA Education Foundation offers a two-day course for new peer reviewers and a one-day refresher course for existing peer reviewers.

During 2014, PROC members attended the one-day training course *AICPA Peer Review Program Advanced Course* on May 21, 2014. A PROC member attended the two-day training course *How to Conduct a Review Under the AICPA Practice Monitoring Program* on June 26-27, 2014.

F. CalCPA Annual Report on Oversight

The AICPA requires that each administering entity perform oversight of its peer review program every other year, alternating with the year that the AICPA conducts its oversight visit. CalCPA's Peer Review Administrative Committee (PRAC) monitors the oversight process. Each member of the PRAC has been approved by the Council of CalCPA and has current audit experience.

The PROC reviewed the CalCPA Peer Review Program Annual Report on Oversight for Calendar Year 2012. The oversight report summarizes the results of the mandated oversight of two percent of all reviews processed during the year and verification of the resumes and continuing professional education of one third of peer reviewers.

G. Oversight Visit Report of CalCPA

In years when the AICPA Peer Review Board does not perform oversight of the CalCPA, a member of the CalCPA PRC performs an Administrative Oversight Visit.

The PROC reviewed the report of the Administrative Oversight Visit to the CalCPA conducted by PRC Chair David E. Vaughn, CPA on December 3, 2013. The report had no findings or recommendations for the administration of the program.

iii. NPRC

A. NASBA Compliance Assurance Committee (CAC)

The charge of the NASBA CAC is to promote effective oversight of compliance with professional standards by CPAs and their firms. As such, the focus of the NASBA CAC is to recommend a nationwide strategy promoting a mandatory program for compliance assurance acceptable to Boards of Accountancy – PROCs. The NASBA CAC provides oversight of the NPRC.

The PROC reviewed a summary of the NASBA CAC meeting held on June 26, 2014 and two PROC members observed the September 10, 2014 CAC meeting via teleconference.

B. NASBA CAC Report on the AICPA NPRC

The PROC reviewed the NASBA CAC report on the AICPA NPRC dated March 31, 2014. During the period November 1, 2011 through October 31, 2012 two former state board members sat as members on the AICPA NPRC. These members participated in 18 of the 25 RAB meetings held during this time period which represented 72 percent of the total RABs.

Based on the oral reports provided at each CAC meeting by the NASBA representatives serving as members on the AICPA NPRC, as well as reviewing the comprehensive oversight report prepared by the AICPA NPRC and the administrative oversight report issued by a third party on October 26, 2012, the NASBA CAC is satisfied and can report that the AICPA NPRC has operated appropriately for the period of November 1, 2011 to October 31, 2013.

iv. Other State Societies

Most California-licensed accounting firms use CalCPA or AICPA NPRC to administer their peer reviews. There are some California-licensed firms that

have their peer reviews administered by AICPA administering entities other than CalCPA and AICPA NPRC, meaning out-of-state CPA societies.

The PROC intends on reviewing the AICPA oversight visit report and the state PROC's annual report, if available, for a selection of out-of-state administrative entities each year. All AICPA oversight visit reports are reviewed and accepted by the AICPA PRB Oversight Task Force.

c. Other Activities

i. NASBA PROC Summit

The PROC Summit is a conference held by the NASBA CAC every other year to support and promote Peer Review Oversight as a critical and valuable practice for all boards of accountancy. The conference is intended to assist boards of accountancy in learning how to establish a new PROC and also share experiences among existing PROCs to help each board of accountancy be more effective with peer review oversight. Sessions and content are formed based on the most requested information by accountancy board members and PROC members considering the goals and objectives of the NASBA CAC. A PROC Summit was not held in 2014.

IX. Statistics

The data in the following table reflects the number of peer review reports accepted by the CalCPA from 2012 through 2014, and provides perspective on the size of the peer review program in California. The table does not include statistics for peer reviews accepted by the NPRC or out-of-state administering entities.

Peer Review Reports Accepted by the CalCPA*				
Type of Review	**2012**	**2013**	**2014**	**Total**
System	648	517	507	1,672
Engagement	1,253	1,184	1,102	3,539
Total	1,901	1,701	1,609	5,211

*Data received from CalCPA as of October 17, 2014.

X. Findings

Based on PROC members' attendance at the various peer review bodies' meetings cited in this report, the PROC offers the following findings to the CBA.

<u>AICPA</u>

The PROC found the AICPA PRB to give ample consideration to the quality of the profession, and exhibit a high level of technical knowledge and diligence in striving

to improve the quality of the peer review program and peer reviewers through their handling of a variety of issues that the program faces. The PROC found the agenda items for the meetings to be relevant and appropriate, and AICPA PRB members to execute their duties in a knowledgeable and professional manner understanding the importance of the peer review program to the accounting profession and the public that it serves.

In 2014, the U.S. Department of Labor (DOL) requested that the AICPA verify that all public accounting firms conducting audits of pension plans under the Employee Retirement Income Security Act (ERISA) were enrolled in peer review. The AICPA conducted a matching program and determined that some firms may not have appropriately identified the performance of ERISA pension plan audits prior to the completion of the firm's peer review. As such, these types of engagements may not have been reviewed during the peer review.

The AICPA was found to be responsive to the DOL's concerns. The AICPA PRB approved new guidance requiring that an administrative entity "recall its acceptance letter when notified by staff that the peer review report is not correct in all material respects. The peer review information and peer review documents must be removed from view on Facilitated State Board Access, and the administering entity must notify the applicable state board(s) of accountancy of information allowed by the guidance."

CalCPA

The PROC found the CalCPA PRC met expectations concerning knowledge of peer review acceptance procedures and corrective/monitoring actions. Through participation in five RAB meetings, the PROC found RAB members met expectations concerning knowledge of technical and procedural matters.

NPRC

In 2014, the PROC began participating in NASBA CAC meetings and reviewing summaries of CAC meetings not open to PROC members.

XI. Conclusions

Based on its oversight activities, the PROC concluded that the AICPA Peer Review Program, including its administering entities, CalCPA and NPRC, function effectively. The PROC recommends that the CBA continue to recognize the AICPA Peer Review Program as a Board-recognized Peer Review Program Provider.