

STATE OF MINNESOTA
BOARD OF ACCOUNTANCY

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March 23, 1994

To: Maryann Hruby
Legislative Commission to Review Administrative Rules

From: Dave O'Connell
Executive Secretary
Minnesota State Board of Accountancy

A handwritten signature in cursive script, appearing to read "Dave O'Connell".

Re: proposed rules regarding Practice Monitoring

Enclosed is the Statement of Need and Reasonableness for
this set of proposed rules.

Thank you for your continued cooperation.

3/21/94
✓

BEFORE THE MINNESOTA
BOARD OF ACCOUNTANCY

In the Matter of the
Proposed Adoption of
Rules of the Board of
Accountancy Relating to
Practice Monitoring

NOTICE OF INTENT TO
ADOPT RULES WITHOUT
A PUBLIC HEARING

Notice is hereby given that the Minnesota Board of Accountancy ("Board") intends to adopt a permanent rule without a public hearing following the procedures set forth in the Administrative Procedure Act, Minnesota Statutes, sections 14.22 to 14.28. You have until 4:30 p.m. on April 22, 1994 to submit a written request that a hearing be held on the rule.

Agency Contact Person. Comments or questions on the rule and written requests for a public hearing on the rule must be submitted to:

David J. O'Connell
Executive Secretary
Minnesota Board of Accountancy
Suite 125
85 East Seventh Place
St. Paul, Minnesota 55101
Telephone: (612) 296-7937

Subject of Rule and Statutory Authority. The proposed rule is about the Board of Accountancy Relating to Practice Monitoring. The statutory authority to adopt this rule is Minn. Stat. § 326.18 (1992). A copy of the proposed rule is published in the State Register and attached to this notice as mailed. A free copy of the rule is available upon request from the agency contact person listed above.

Comments. You have until 4:30 p.m. on April 22, 1994, to submit written comment in support of or in opposition to the proposed rule and any part of subpart of the rule. Your comment must be in writing and received by the agency contact person by the due date. Comment is encouraged. Your comment should identify the portion of the proposed rule addressed, the reason for the comment, and any change proposed.

Request for a Hearing. In addition to submitted comments, you may also request that a hearing be held on the rule. Your request for a public hearing must be in writing

and must be received by the agency contact person by 4:30 p.m. on April 22, 1994. Your written request for public hearing must include your name and address. You are encouraged to identify the portion of the proposed rule which caused your request, the reason for the request and any changes you want made to the proposed rule. If 25 or more persons submit a written request for a hearing, a public hearing will be held unless a sufficient number withdraw their requests in writing. If a public hearing is required, the agency will follow the procedures in Minnesota Statutes, sections 14.131 to 14.20 (1992).

Modifications. The proposed rule may be modified as a result of public comment. The modifications must be supported by data and view submitted to the agency and may not result in a substantial change in the proposed rules as attached and printed in the State Register. If the proposed rule affects you in any way, you are encouraged to participate in the rulemaking process.

Statement of Need and Reasonableness. A statement of need and reasonableness is now available from the agency contact person. This statement describes the need for and reasonableness of each provision of the proposed rule and identifies the data and information relied upon to support the proposed rule.

Small Business Considerations. It is the position of the Board that Minn. Stat. § 14.115 (1992) relating to small business considerations in rulemaking does not apply to the rules it promulgates. Minn. Stat. § 14.115, subd. 7(2) (1992) states that section 14.115 does not apply to "agency rules that do not affect small businesses directly." The Board's authority relates only to public accountants and not to the businesses they operate.

However, should these proposed rules in some way be construed as being subject to Minn. Stat. § 14.115, the Board notes below how the five suggested methods listed in section 14.115, subdivision 2, for reducing the impact of the rules on small businesses should be applied to the proposed rules. The five suggested methods enumerated in subdivision 2 are as follows:

(a) The establishment of less stringent compliance or reporting requirements for small businesses;

(b) The establishment of less stringent schedules or deadlines for compliance or reporting requirements for small businesses;

(c) The consolidation or simplification of compliance or reporting requirements for small businesses;

(d) The establishment of performance standards for small businesses to replace design or operational standards required in the rule; and

(e) The exemption of small businesses from any or all requirements of the rule.

The feasibility of implementing each of the five suggested methods and whether implementing any of the five methods would be consistent with the statutory objectives that are the basis for this rulemaking are considered below.

1. It would not be feasible to incorporate any of the five suggested methods into these proposed rules.

Methods (a) to (c) relate to lessening compliance or reporting requirements for small businesses either by establishing less stringent requirements, establishing less stringent schedules or deadlines for compliance with the requirements, or consolidating or simplifying the requirements. Since the Board is not proposing any compliance or reporting requirements for either small or large businesses, it follows that there are no such requirements for the Board to lessen with respect to small businesses. If, however, these proposed rules are viewed as compliance or reporting requirements for businesses, then the Board finds that it would be unworkable to lessen the requirements for those public accountants who practice in a solo or clinic setting of fewer than 50 employees, since that would include at a minimum the vast majority of licensees and probably all of them. Method (d) suggests replacing design or operational standards with performance standards for small businesses. The Board's rules do not propose design or operational standards for businesses and therefore there is no reason to implement performance standards for small businesses as a replacement for design or operational standards that do not exist. Finally, method (e) suggests exempting small businesses for any or all requirements of the rules.

The application of this provision would exempt virtually all licensees from the purview of the rules, a result which would be absurd.

2. Reducing the impact of the proposed amendments on small businesses would undermine the objectives of the Minnesota licensing law for public accountants.

Pursuant to Minn. Stat. § 326.165 et seq., the Board was created for the purpose of establishing requirements for licensure and adopting standards for disciplinary action to govern the practices or behavior of all licensees. Pursuant to Minn. Stat. § 326.18, the Board is specifically mandated to promulgate rules as may be necessary to carry out the Board's purposes. Given these statutory mandates, it is the Board's duty to establish licensure qualifications and disciplinary standards which apply to and govern all applicants and licensees regardless of the nature of their practice. As stated above, it is the Board's position that the proposed rules will not affect small businesses and certainly do not have the potential for imposing a greater impact on public accountants in a solo or small practice than on those practices large enough to remove them from the definition of small business. It has also been explained above that the Board considers it infeasible to implement any of the five suggested methods enumerated in subdivision 2 of the small business statute. Nonetheless, to the extent that the proposed rules may affect the business operation of a public accountant or group of public accountants and to the extent it may be feasible to implement any of the suggested methods for lessening the impact on small businesses, the Board believes it would be unwise and contrary to the purposes to be served by these rules for the Board to exempt one group of public accountants - indeed, the vast majority of public accountants and perhaps the entire profession - from the requirements of these rules. Similarly, the Board believes it would be unwise and contrary to its statutory mandate for the Board to adopt one set of standards for those public accountants (which may consist of a nonexistent class) who work in a large business setting and adopt another, less stringent, set of standards to be applied to those public accountants who practice in a solo or small clinic practice. It is the Board's view that these rules must apply equally to all public accountants if the public whom they serve is to be adequately protected.


Licensees, regardless of whether they are considered as individuals or small businesses, have had and will continue to have an opportunity to participate in the rulemaking process for these proposed rules. The Board has used a very open process to draft these rules and has kept the various associations well informed of the proposed rules as they were developed. The associations have in turn informed their constituents.

Expenditure of Public Money by local Public Bodies and Impact on Agricultural Land. Promulgation of these proposed rules will not result in the expenditure of public monies by local public bodies nor have any impact on agricultural land; therefore, no further information need be provided under Minn. Stat. § 14.11 (1992).

Adoption and Review of Rule. If no hearing is required after the end of the comment period the Board may adopt the rule. The rule and supporting documents will then be submitted to the Attorney General for review as to legality and form to the extent form relates to legality. You may request to be notified of the date the rule is submitted to the Attorney General or be notified of the Attorney General's decision on the rule. If you wish to be so notified, or wish to receive a copy of the adopted rule, submit your request to the agency contact person listed above.

Dated: March 7, 1994

STATE OF MINNESOTA
BOARD OF ACCOUNTANCY



DAVID J. O'CONNELL
Executive Secretary

1 Board of Accountancy
2
3 Proposed Permanent Rules Relating to Practice Monitoring
4
5 Rules as Proposed (all new material)

6 PRACTICE MONITORING

7 1100.9100 DEFINITIONS.

8 Subpart 1. Scope. For the purpose of parts 1100.9100 to
9 1100.9900 the terms in this part have the meanings given.

10 Subp. 2. Adverse report. "Adverse report" is a report
11 that describes nonconformance with the professional standards
12 established by the AICPA in Standards for Performing and
13 Reporting on Quality Reviews, effective April 1, 1994.

14 Subp. 3. AICPA. "AICPA" means the American Institute of
15 Certified Public Accountants.

16 Subp. 4. Licensed practice unit or LPU. "Licensed
17 practice unit" or "LPU" means a corporation, partnership,
18 limited liability company (LLC), limited liability partnership
19 (LLP), or sole proprietorship licensed under Minnesota Statutes,
20 section 326.20, to practice public accounting in Minnesota.

21 Subp. 5. Qualified report. "Qualified report" means a
22 report that describes deficiencies in the work reviewed or the
23 related quality control system, or both, when compared with the
24 professional standards established by the AICPA in Standards for
25 Performing and Reporting on Quality Reviews, effective April 1,
26 1994.

27 Subp. 6. Quality review. "Quality review" means a study,
28 appraisal, or review of one or more aspects of the professional
29 work, including its related quality control system, of a person
30 or firm (LPU) in the practice of public accountancy by a
31 reviewer who meets the requirements of part 1100.9600.

32 Subp. 7. Report acceptance body. "Report acceptance body"
33 means the organization that accepts the quality review report
34 from the reviewer, reviews it, and determines what, if any,
35 action the LPU shall take in order to bring the LPU's practice



1 up to the professional standards set forth in part 1100.4650.

2 Subp. 8. Reporting year. "Reporting year" means the year
3 after the quality review has been conducted. It is the year in
4 which the licensee will send the quality review report to the
5 board.

6 Subp. 9. Reviewer. "Reviewer" means the licensed
7 individual or firm selected to conduct the quality review.

8 Subp. 10. Unqualified report. "Unqualified report" means
9 a report that describes no deficiencies in the work reviewed or
10 the related quality control system, or both, when compared with
11 the professional standards established by the AICPA in Standards
12 for Performing and Reporting on Quality Reviews, effective April
13 1, 1994.

14 Subp. 11. Year of review. "Year of review" means the year
15 during which the quality review will be conducted.

16 Subp. 12. Year under review. "Year under review" means
17 the year prior to the year in which the quality review is
18 actually started. It is the third and final year of a
19 licensee's three-year reporting cycle.

20 1100.9150 INCORPORATION BY REFERENCE.

21 For purposes of part 1100.9100, Standards for Performing
22 and Reporting on Quality Reviews, effective April 1, 1994, is
23 incorporated by reference. This document is published by the
24 American Institute of Public Accountants, Inc., New York, New
25 York 10036-8775. It is not subject to frequent change and is
26 available at the state law library.

27 1100.9200 REQUIREMENT FOR QUALITY REVIEW; AREAS TO BE REVIEWED.

28 As a condition to renewal of its license pursuant to
29 Minnesota Statutes, section 326.20, every LPU shall undergo a
30 quality review in accordance with parts 1100.9100 to 1100.9900
31 once every three years. The quality review is limited to the
32 LPU's accounting and auditing practice and its related quality
33 control system.

34 1100.9300 EXEMPTION FROM QUALITY REVIEW.

1 An LPU is exempt from the quality review requirement in
2 part 1100.9200 if it annually represents to the board that it
3 does not engage in audits, reviews, or compilations; that it
4 does not intend to engage in such practices during the following
5 year; and that it shall immediately notify the board in writing
6 if it engages in such practices.

7 The representation shall be made in writing, under oath,
8 and upon forms provided by the board. The representation shall
9 be made annually at the time the LPU applies for renewal of its
10 license.

11 If an LPU under exemption notifies the board that it has
12 performed an audit, review, or compilation, it shall undergo a
13 quality review during the first full year after its initial
14 acceptance of an engagement, or sooner at the request of the LPU.

15 1100.9400 INITIAL QUALITY REVIEW CYCLE.

16 Subpart 1. Past participation in quality review. LPUs
17 that are participating in a quality review program on the
18 effective date of this part shall comply with items A to C.

19 A. LPUs whose year under review ended in 1993 shall
20 have quality reviews performed in 1994, which will be their year
21 of review, and submit the material specified in part 1100.9800
22 to their report acceptance bodies 15 days after receiving it
23 from their reviewers, and to the board by June 30, 1995.

24 B. LPUs whose year under review ended in 1994 shall
25 have quality reviews performed in 1995, which will be their year
26 of review, and submit the material specified in part 1100.9800
27 to their report acceptance bodies 15 days after receiving it
28 from their reviewers, and to the board by June 30, 1996.

29 C. LPUs whose year under review ended in 1995 shall
30 have quality reviews performed in 1996, which will be their year
31 of review, and submit the material specified in part 1100.9800
32 to their report acceptance bodies 15 days after receiving it
33 from their reviewers, and to the board by June 30, 1997.

34 Subp. 2. First time participation in quality review. LPUs
35 that did not participate in quality review programs prior to the

1 effective date of this part, and are subject to the quality
2 review programs for the first time, shall have reviews performed
3 in either 1995 or 1996, which will be their year of review.
4 LPUs shall submit the material specified in part 1100.9800 to
5 their report acceptance bodies and to the board according to the
6 following schedule:

7 A. LPUs with license numbers whose last digit is even
8 shall have quality reviews performed in 1995, and submit the
9 material specified in part 1100.9800 to their report acceptance
10 bodies 15 days after receiving it from their reviewers, and to
11 the board by June 30, 1996.

12 B. LPUs with license numbers whose last digit is odd
13 shall have quality reviews performed in 1996, and submit the
14 material specified in part 1100.9800 to their report acceptance
15 bodies 15 days after receiving it from their reviewers, and to
16 the board by June 30, 1997.

17 After the initial report, LPUs shall be required to report
18 every three years on the anniversary of their first reporting
19 date.

20 1100.9500 NEW LPUs; QUALITY REVIEW CYCLE.

21 As a condition of licensing, a new LPU shall undergo a
22 quality review during the first full year after it becomes
23 subject to the requirements for quality review, and shall report
24 the material specified in part 1100.9800 to the board by June 30
25 of the second full year after becoming subject to the
26 requirements for quality review.

27 After the initial report, the LPU shall be required to
28 report every three years on the anniversary of the June 30
29 reporting date.

30 A new LPU is one that has not been previously licensed in
31 Minnesota or has not had a quality review completed in the
32 three-year period prior to application. It does not include the
33 following:

34 A. An LPU that has been previously licensed in this
35 state and changes its name or the legal form of its practice,

1 but retains the same practice.

2 B. A new partnership, corporation, LLC, or LLP formed
3 by more than one previous LPU which were already scheduled for
4 quality review. The quality review of this LPU shall be
5 conducted in the later of the years for which each of the former
6 LPUs was scheduled.

7 C. A partnership, corporation, LLC, or LLP that is
8 dissolved with each individual LPU taking clients from the
9 partnership or corporation. The quality review for each of
10 these individual LPUs remains in the same year to which the
11 original partnership, corporation, LLC, or LLP was assigned.

12 D. A partnership, corporation, LLC, or LLP that is
13 dissolved with one partner or shareholder taking all of the
14 existing clients. The quality review for the LPU taking over
15 the existing business remains in the year to which the
16 partnership, corporation, LLC, or LLP was originally assigned.

17 1100.9600 QUALIFICATIONS OF REVIEWER.

18 The reviewer shall have the following minimum
19 qualifications:

20 A. be licensed to practice as a CPA or LPA; or a CPA,
21 LPA, LLC, or LLP firm, by any state; and have undergone at least
22 one quality review;

23 B. have knowledge and experience with the type of
24 reports and financial statements to be reviewed, including
25 experience in supervision of the preparation of such reports and
26 statements;

27 C. be independent, as defined by part 1100.4400, of
28 the LPU under review;

29 D. have no conflict of interest, as defined in part
30 1100.4500, as proposed at 18 State Register 1818;

31 E. be familiar with all services in the area of
32 auditing and accounting provided by the LPU subject to review;

33 F. be familiar with the procedure for conducting a
34 quality review in accordance with the standards set forth by the
35 AICPA; and

1 G. have attended a quality review seminar sponsored
2 by the board, the AICPA, the National Society of Public
3 Accountants, another state board, or another professional
4 accounting organization.

5 1100.9700 QUALIFICATIONS OF REPORT ACCEPTANCE BODIES.

6 The AICPA is an approved report acceptance body.

7 The Minnesota Association of Professional Accountants, the
8 Minnesota Society of Certified Public Accountants, other state
9 accountancy boards, and any other organization able to
10 demonstrate that it will fulfill its responsibilities in
11 accordance with the review standards as established by the
12 AICPA, and incorporated by reference in part 1100.9150, may
13 apply to the board to be considered a report acceptance body.
14 The board shall approve applications to be considered a report
15 acceptance body if the applicant demonstrates that it has or
16 will fulfill its responsibilities in accordance with the review
17 standards as established by the AICPA, and incorporated by
18 reference in part 1100.9150. Approval shall be withdrawn if a
19 report acceptance body fails to fulfill its responsibilities in
20 accordance with the review standards as established by the
21 AICPA, and incorporated by reference in part 1100.9150.

22 The report acceptance body shall not make membership a
23 condition of acting as a report acceptance body for any LPU.

24 1100.9800 REPORT TO BOARD.

25 Subpart 1. Required submittals. By June 30 of each year,
26 each LPU that is scheduled to report that year shall submit the
27 following material to the board:

28 A. a copy of the qualified, adverse, or unqualified
29 report issued by the reviewer, including any letters of comment
30 and responses;

31 B. the final letter of approval from the report
32 acceptance body; and

33 C. any agreements to correct deficiencies that have
34 been entered into between the LPU and the report acceptance body.

35 The board shall review this material prior to relicensing

1 the LPU.

2 Failure to file the required material by June 30 of its
3 reporting year shall be cause for discipline against the LPU's
4 certificate and license.

5 In the case of a qualified or adverse report, where the
6 report acceptance body and the LPU have entered into an
7 agreement to correct deficiencies, failure by the LPU to abide
8 by that agreement shall be grounds for discipline against the
9 LPU's certificate and license.

10 Subp. 2. Board requirements. In addition to any agreement
11 made between the report acceptance body and the LPU, the board
12 may:

13 A. require that the members of the LPU firm complete
14 continuing education in the areas of deficiency in addition to
15 the continuing professional education hours required in part
16 1100.6500;

17 B. require that the LPU maintain a minimum library of
18 source materials designed to provide the LPU with the resources
19 necessary to cure the deficiencies noted; and

20 C. impose any other discipline authorized by
21 Minnesota Statutes, section 326.229, subdivision 4.

22 1100.9900 PRIVATE DATA.

23 The board shall treat the quality review reports of the
24 reviewer and the report acceptance body, and all material of the
25 LPU, as private data as defined by Minnesota Statutes, section
26 13.02, subdivision 12, or nonpublic data as defined by Minnesota
27 Statutes, section 13.02, subdivision 9, as applicable.

28 If an LPU becomes the subject of a disciplinary proceeding
29 pursuant to Minnesota Statutes, section 326.229, the board may
30 make the information public in accordance with Minnesota
31 Statutes, chapter 14.

Office of the Revisor of Statutes

Administrative Rules



TITLE: Proposed Permanent Rules Relating to Practice Monitoring

AGENCY: Board of Accountancy

MINNESOTA RULES: Chapter 1100

INCORPORATIONS BY REFERENCE:

Part 1100.9150: Standards for Performing and Reporting on Quality Reviews, effective April 1, 1994, published by the American Institute of Public Accountants, Inc., New York, New York 10036-8775.

This document is available at the state law library

The attached rules are approved for
publication in the State Register

A handwritten signature in cursive script, appearing to read "Carla M. Riehle".

Carla M. Riehle
Senior Assistant Revisor

STATEMENT OF NEED AND REASONABLENESS

(Proposed Permanent Rules Relating to Practice Monitoring)

HISTORY - The idea of practice monitoring, peer review, quality review, positive enforcement whatever you choose to call it, is not a new idea. More than 30 states have adopted some sort of system. The national system is run by the American Institute of Certified Public Accountants (AICPA). They have a very well defined plan which is spelled out in their publication, "Standards for Performing and Reporting on Quality Reviews," effective April 1, 1994, as amended.

Most large CPA and LPA firms that do audits have been complying with national quality review programs for years based upon the highest level of their practice. They either fell under the AICPA Private Company Practice Section (PCPS), the AICPA Security and Exchange Commission Practice Section (SECPS), or the Quality Review Program which is run by the State affiliates of the AICPA. Membership in the AICPA is conditioned on participating in the appropriate practice monitoring program.

In Minnesota we began looking at a Board sanctioned practice monitoring program about a year ago. We brought together representatives from the Board, the Minnesota Society of Certified Public Accountant's (the local affiliate of the AICPA), and the Minnesota Association of Public Accountants (the other large professional group in Minnesota and nationally).

As we started looking at this issue, everyone agreed it would be easier to pattern these rules after an existing program that was working and modify it to meet our needs rather than starting from scratch. We therefore purchased a copy of the 200 plus page South Dakota Quality Review Manual and worked off of their set of rules. A history of their program, which became effective July 1, 1987, is attached.

1100.9100 Definitions

Subp. 2. Using the term "adverse report" to describe a non-conforming report is necessary since it is the best description possible of the report and is reasonable in that

it is the commonly used term in the profession. Thus users of the rule will recognize it easily when using these rules.

Subp. 3. Using the term "AICPA" is necessary to identify the American Institute of Certified Public Accountants and is reasonable in that this is the abbreviation for the Institute commonly used in the profession. Thus, users of the rule will recognize it easily when using these rules.

Subp. 4. Using the term "licensed practice unit" is necessary to describe the class of people and firms who are subject to the rules. It is reasonable in that it accurately describes the class, distinguishing them from applicants, certificate holders, and individual licensees who are not subject to these rules.

Subp. 5. Using the term "qualified report" to describe a report that identifies some deficiencies is necessary since it is the best description possible of the report and is reasonable in that it is the commonly used term in the profession. Thus users of the rule will recognize it easily when using these rules.

Subp. 6. This definition is necessary to give practitioners notice of what kind of program we are taking about. This is a commonly used definition that will be easily recognized by everyone in the profession and will give them notice of the program.

Subp. 7. Using the term "report acceptance body" is necessary in that it is the best description possible of the entity that

receives the report from the reviewer and is reasonable in that it is the commonly used term in the profession. Thus users of the rule will recognize it easily when using these rules.

Subp. 8. Using the term "reporting year" is necessary in that it is the best description possible of the year in which the report is to be submitted and is reasonable in that it is the commonly used term in the profession. Thus users of the rule will recognize it easily when using these rules.

Subp. 9. Using the term "reviewer" is necessary in that it is the best description possible of the entity that does the review and is reasonable in that it is the commonly used term in the profession. Thus users of the rule will recognize it easily when using these rules.

Subp. 10. Using the term "unqualified report" is necessary in that it is the best description possible of a good report and is reasonable in that it is the commonly used term in the profession. Thus users of the rule will recognize it easily when using these rules.

Subp. 11. Using the term "year of review" is necessary in that it is the best description possible of the year during which the review will be done and is reasonable in that it is the commonly used term in the profession. Thus users of the rule will recognize it easily when using these rules.

Subp. 12. Using the term "year under review" is necessary in that it is the best description possible of the year which is actually the subject of the review and is reasonable in that it is the commonly used term in the profession. Thus users of the rule will recognize it easily when using these rules.

1100.9150 Incorporation by reference

This section is necessary in order to clarify that we are in fact attempting to implement a program which is in substantial compliance with the AICPA's national program and that which many other states have adopted. What the Board is proposing is to be consistent with the standards commonly accepted in the profession. It is reasonable in that it gives further guidance and clarification to the users of the rule as to what is expected of them.

1100.9200 Requirement for quality review. This language is necessary to establish the Board's authority for quality review and to define exactly what the review will consist of. It is reasonable in that the Public Accountancy Act (Minnesota Statutes, Section 326.18) gives the Board the responsibility to "make rules necessary to implement and enforce sections 326.165 to 326.229, and 214.12, including but not limited to rules of professional conduct, pertaining to individuals, partnerships and corporations practicing public accounting which it deems consistent with or required by the public welfare...." And that the experience of other states and the

clear trend is that programs such as this one are very beneficial to development and retention of professional skills; and proactively protect the public, doing so far better than resolving competence problems through after-the-fact client complaints.

1100.9300 Exemption from Quality Review This rule is necessary to exclude from quality review those parts of the practice for which measurable quality review criteria have not been developed and implemented. This rule is reasonable in that it is the current professional standard and it would be unreasonable for Minnesota to attempt to adopt a quality review program for those parts of the practice that no one else has been able to implement a program for.

1100.9400 Initial Quality Review Cycle This rule established the three year review cycle that LPU's will find themselves on. It is necessary to establish some sort of initial grouping of participants. This is reasonable because it allows those who are already participating in another quality review program to stay on the very same schedule they are currently on. It gives reasonable notice to all LPU's as to how their cycle will be established in the future. And it creates a system for dealing with new LPU's that have not participated in the past. It is a reasonable system, one designed to be fair and give adequate notice to all LPU's of their obligations and responsibilities.

1100.9500 New LPU's This section is necessary in order to determine when a new LPU is created and when it is not. The section is modeled after South Dakota law but also incorporates all of the Minnesota forms of practice. It is reasonable in that it gives guidance about when a new LPU is created and how to treat that entity.

1100.9600 Qualifications of Reviewers This rule is necessary to ensure that reviewers in this program are of the same high standards as reviewers in national and other state programs. It adopts the same standards. It is reasonable in that it gives potential reviewers a list of standards they must meet and LPU's a standard that they can expect from their reviewer.

1100.9700 Qualifications of Report Acceptance Bodies This rule is necessary to insure that Report Acceptance Bodies in this program are of the same high standards as those in national and other state programs. It adopts the same standards. It is reasonable in that it gives potential report acceptance bodies a list of standards they must meet and LPU's a standard that they can expect from their report acceptance body. This is one area where the Minnesota program would differ from the South Dakota program in that the South Dakota State Board operates as the Report Acceptance Body, whereas in our proposed rules, other groups will be the Report Acceptance Bodies for the Board. This distinction is reasonable because the standards established by

these rules for Report Acceptance Bodies are high and because it will reduce the cost to the Board and to the LPU's. It is necessary given the much larger number of LPU's that Minnesota has vs. South Dakota.

1100.9800 Report to the Board This again is somewhat different from the South Dakota approach in that the Minnesota Board would get the final report from the Report Acceptance Body. It is necessary for the Board to get the final report in that the Board will use this information in its licensing and re-licensing decisions. It is reasonable to adopt this regulatory scheme because the Board retains the final jurisdiction to review the report and the recommendations from the reviewer and Report Acceptance Body. The ultimate decision on what action to take, if any, lies with the Board. This is both necessary because it is the Board's responsibility and reasonable.

1100.9900 Private Data This section is necessary to insure that the Minnesota Government Data Practices Act is followed in the gathering, reporting, and retention of this information. It is reasonable in that it gives notice to all users of the system that the Board will be following the Data Practices Act's requirements.

RULE CHANGES - IMPACT ON SMALL BUSINESS

The Board notes below how the five suggested methods listed in Minnesota Statutes, Section 14.115, subdivision 2 for reducing the impact of the rules on small businesses should be applied to the proposed rules. The five suggested methods enumerated in subdivision 2 are as follows:

- (a) The establishment of less stringent compliance or reporting requirements for small businesses;
- (b) The establishment of less stringent schedules or deadlines for compliance or reporting requirements for small businesses;
- (c) The consolidation or simplification of compliance or reporting requirements for small businesses;
- (d) The establishment of performance standards for small businesses to replace design or operational standards required in the rule; and
- (e) The exemption of small businesses from any or all requirements of the rule.

The feasibility of implementing each of the five suggested methods and whether implementing any of the five methods would be consistent with the statutory objectives that are the basis for this rulemaking are considered below.

1. It would not be feasible to incorporate any of the five suggested methods into these proposed rules.

Methods (a) to (c) relate to lessening compliance or reporting requirements for small businesses either by establishing less stringent requirements, establishing less stringent schedules or deadlines for compliance with the requirements, or consolidating or simplifying the requirements. The Board finds that it would be unworkable to lessen the requirements for those licensees who practice as sole practitioners or in a practice consisting of fewer than 50 employees, since that would include, at a minimum, the vast majority of all licensees. Method (d) suggests replacing design or operational standards with performance standards for small businesses. The Board's rules do not propose design or operational standards for businesses and therefore there is no reason to implement performance standards for small businesses as a replacement for design or operational standards that do not exist. Finally method (e) suggests exempting small businesses from any or all requirements of the rules. The application of this provision would exempt a large percentage of licensees from the purview of the rules, which would not make sense given the responsibility of the Board to protect the public and the importance of these rules in meeting that responsibility.

2. Reducing the impact of the proposed amendments on small businesses would undermine the objectives of the Minnesota licensing law.

Pursuant to Minnesota Statutes, Section 326.165, et seq., the Board was created for the purpose of establishing requirements for

licensure and adopting standards for disciplinary action to govern the practices or behavior of all licensees. Pursuant to Minnesota Statutes, Section 326.18, the Board is specifically mandated to promulgate rules as may be necessary in order to carry out the Board's purpose. Given these statutory mandates, it is the Board's duty to establish practice monitoring standards which apply to and govern all applicants regardless of the size of their practice.

However, the Board does recognize (as do all the other quality review programs) that there are in fact no standards for a "tax-only" practice and that those licensees with that type of practice will be excluded from the program. The program focuses on those LPU's whose practices include compilations with opinion, reviews, and audits. Small public accounting businesses who do not include that part of the practice in their work are exempted from these rules.

The Board considers it unfeasible to implement any of the five suggested methods enumerated in subdivision 2 of the Small Business statute - to exempt businesses based solely on their size, but has created the exemption based upon the content of the practice - which has some relevance to size. It is the Board's experience that smaller practices are less likely to perform the types of work which would bring them under the purview of this

rule. Conversely, however, those smaller LPU's who do perform compilations with opinions, reviews, and audits should especially be covered by these rules because they lack the resources, experience, and internal controls of larger LPU's. Public protection, therefore, requires that all licensees be treated equally.

Similarly, the Board believes it would be unwise and contrary to its statutory mandate for the Board to adopt one set of standards for those licensees who work in a large business setting and adopt another, less stringent, set of standards to be applied to those licenses who practice in a sole proprietorship or small practice. It is the Board's view that these rules must apply equally to all licensees who are doing the same kind of public accounting work if the public whom they serve is to be adequately protected.

EXPENDITURE OF PUBLIC MONEY BY LOCAL PUBLIC BODIES AND IMPACT ON AGRICULTURAL LAND.

Promulgation of these rules will not result in the expenditure of public monies by local public bodies nor have any impact on agricultural land; therefore, no further information need be provided under Minnesota Statute, Section 14.11 (1992).

March 7, 1994
March 7, 1994

David J. O'Connell
David J. O'Connell
Executive Secretary
Minnesota State Board of Accountancy

SOUTH DAKOTA BOARD OF ACCOUNTANCY

The History of Quality Review in South Dakota

The South Dakota Board of Accountancy began studying Peer Review in 1979. At a July 31, 1979, meeting, the Board formed the first "peer review committee," which was named the "Positive Enforcement Committee". The composition of this committee was two Board members; a lay person; and one PA and one CPA, as appointed by their respective Societies. The Executive Secretary was also a non-voting member.

The charge to this Committee was "to examine, develop, and recommend to the Board of Accountancy a positive enforcement program for licensees." The program stressed technical standards enforcement.

The first Positive Enforcement Committee meeting was held on March 4, 1980. The meeting was primarily devoted to discussion about the definition and clarification of a Positive Enforcement Program in contrast with a peer review.

The Committee studied materials from other states having Positive Enforcement programs and sections concerning Positive Enforcement Programs from the NASBA Model Public Accountancy Act. At a July 1, 1980, meeting, they voted to recommend to the South Dakota Board of Accountancy a Positive Enforcement Program be adopted.

The Committee met August 5, 1980, to develop a formal presentation of the Positive Enforcement Program to the South Dakota Society of CPAs and PAs.

The proposed Positive Enforcement Program, which was presented to the two Societies, included an explanation of the purpose of such a program, background references regarding "Roots of Peer Review", State Boards of Accountancy progress in Positive Enforcement, findings regarding improper acts, evidence of substandard work and a draft outline of the proposed South Dakota Board of Accountancy's Positive Enforcement Program. The Committee's statement on the purpose of positive enforcement was as follows:

A positive enforcement program is one which emphasizes education and rehabilitation over punitive action, and one which encourages active monitoring of performance as well as reactive responses to complaints. Positive enforcement not only encourages the filing of valid complaints but supplements and improves upon the procedures developed to respond to those complaints. More often than not, the program will focus on substandard work which has not been the subject of a formal complaint.

State Boards have the responsibility of regulating the practice of public accounting and must meet the challenges imposed upon them by the public. If they do not, the public may demand action by other levels of government or will determine a new regulatory structure is needed.

At an October 22, 1980, meeting of the Positive Enforcement Committee, a discussion paper was developed outlining a proposed action program to be used by state societies for implementation of the positive enforcement program. It included steps proposed for a state society professional ethics committee to follow when implementing a positive enforcement program seeking out substandard reports filed with state governments.

The Committee also studied programs already implemented in such states as Arizona, Colorado, Florida, Iowa, Nebraska, Oregon, Washington and Wisconsin. They reviewed this material at a meeting April 28, 1981, and summarized it into report form for presentation to the Board on April 29, 1981.

History of Quality Review in South Dakota

The Positive Enforcement Committee recommended the South Dakota Board work with the state societies as it proceeds further with positive enforcement program development.

The Positive Enforcement Committee met on July 30, 1981, and during this meeting passed the following motions:

"The Positive Enforcement Committee recommends to the South Dakota Board of Accountancy further information on positive enforcement be presented to the State Society Board of Directors (CPA/PA) with a request the respective Boards go on record stating their position regarding the concept of positive enforcement for South Dakota licensees."

"The Positive Enforcement Committee recommends the Board of Accountancy authorize funds for the (1) positive enforcement committee members to attend CPA and PA Society Board of Director meetings to present information regarding positive enforcement and (2) preparation of materials for presentation at the respective meetings".

At a July 31, 1981, Board meeting, a motion was passed that the above recommendations from the Positive Enforcement Committee be accepted.

The Positive Enforcement Committee's purpose was informational, but was without direction to conclusion.

At the July 31, 1981, Board meeting, a new Committee was formed. It was called the "Law and Regulation Review Committee." This Committee had a broader scope than the Positive Enforcement Committee. The Committee's task was to review AICPA, NASBA and other material relating to the regulation of the accounting profession; review recommendations of the Positive Enforcement, Ethics, Education/Experience and Continuing Education Committees; and present a recommendation to the Board concerning an overall legislative package for 1983.

This Committee studied all aspects of a law change, including positive enforcement, which was changed to "Quality Review." After five meetings from January through December, 1982, developing ideas for the new law, the Committee appointed a "Sub-Committee to Draft Position Papers." This sub-committee was charged with the following responsibilities: (1) draw position papers, (2) bring the position papers to the full Law & Regulation Review Committee, (3) present them to the Board of Accountancy and urge the Board to approve and disseminate to all licensees; and 4) present the positions to the Boards of the Societies.

The position reached on Quality Review by the Sub-Committee to Draft Position Papers was as follows:

"A conceptual framework on positive enforcement was discussed by the sub-committee. The concept of positive enforcement was agreed upon as in the public interest. Developing, implementing and administering the concept is the area the subcommittee discussed. The consensus of the subcommittee members was the program should not be designed to heavily regulate, but to encourage, in the public interest, practice which continually seeks to reach high levels of professional competence. Since by definition a professional is one engaged in an occupation seeking high standards within that activity, it appeared reasonable to the Committee that practitioners should indeed be interested in a program which enhances and encourages adherence to acceptable accounting principles, methods and standards, while not impairing professional judgments, procedures and techniques of practice.

The Committee, therefore, concluded the program should be termed, "Report and Workpaper Review," "Engagement Review" or "Quality Review."

History of Quality Review in South Dakota

Positive enforcement would only come into existence when substantial evidence indicated a practitioner's work was substantively deteriorating to the point where his work would be an unacceptable public product in the opinion of the Board. Therefore, it is the consensus of the subcommittee the following position be adopted.

A quality review program for permit holders be adopted by the Board. The program should contain, but not necessarily be limited to, the following elements:

- (1) Areas to be covered should be limited to:
 - A. Audits - (auditing and reporting standards and workpaper review).
 - B. Reviews and compilations - (professional standards and workpaper review).
- (2) The reviewer should adhere to a standardized and uniform review program developed by the Board (limited to audits, reviews and compilations).
- (3) The reviewer should submit an opinion to the Board with any substantive deficiencies conveyed.
- (4) The practitioner would be allowed to seek his own reviewer as long as he had a permit in good standing.
- (5) The cost of the review would be paid by the practitioner.
- (6) SEC and PCPS reviews and opinions would be an acceptable review program.
- (7) If a permit holder receives an adverse opinion, another review should be made the next year; otherwise every three years.

The position of the subcommittee in all areas of the proposed law change, including Quality Review, was adopted by the Law and Regulation Review Committee; and subsequently adopted by the South Dakota Board of Accountancy.

The South Dakota Board of Accountancy drafted a new accountancy law, which was submitted to and passed by the Legislature during the 1984 Session. This law became effective July 1, 1984; however, the provision setting forth Quality Review as a condition of firm permit renewal was not effective until July 1, 1987. The law only set forth the condition of Quality Review; however, the procedures for implementing the program were left to be determined by rule.

During the fiscal year, July 1, 1985, through June 30, 1986, a committee appointed by the Board studied proposed rules for the implementation of the Quality Review program. This committee was named the Quality Review Rules Committee and its membership consisted of two Board members and two Society representatives, one from the CPA Society and one from the PA Society.

The initial meeting of the Committee was July 11, 1985. It was determined there were six areas the Quality Review rules should address. These areas were: (1) area of review, (2) firm selection and notification process, (3) equivalent reviews accepted, (4) qualifications of reviewers, (5) selection of reviewers, and (6) procedure in cases of adverse findings. The committee agreed to use these six guidelines in formulating proposed rules.

History of Quality Review in South Dakota

The Committee members studied these six areas and by an October 22, 1985, meeting developed a consensus of opinion regarding them. These were as follows:

Area of Review

- 1) Scope of the Review: Reviews should include audit, compilation and reviews (and financial statement forecast/projections for each level of service).
- 2) Extent of the Review: A phase of the review program be developed with report only the first year with the right to request workpapers in certain situations.
- 3) Scope of Checklists for Reviewer: The AICPA Division of Firms checklist was adequate and it, or an equivalent thereof, should be used.
- 4) Format of Reports and Letters of Comment: It was the opinion of the Committee the Board should tailor their own forms.
- 5) Number of Engagements That Should Be Reviewed in Each Review: Selection alternatives should be set by policy and not by rule.

Firm Selection and Notification Process

- 1) Method of Selection of Firm: Selection should be based on the extent of accounting and auditing work done. A self-assessment questionnaire could be included on the annual renewal form.
- 2) Timing of Reviews: Reviews should be conducted between May and November each year.
- 3) Frequency of Reviews: Reviews should be done every three years. Unless the Board specifies, no firm will be reviewed two years in a row. New firms should be reviewed within two years of their initial permit to practice in the state.
- 4) Timing of Notification of Selection of Firms: All firms should be notified on January 1, that reviews will be conducted between May and November for the previous calendar year as of the audit date.
- 5) Procedures for Notification: All firms should be notified on January 1, they will be reviewed for the previous calendar year and a self-assessment questionnaire could be included on the annual renewal form.

Equivalent Reviews Accepted

Peer reviews under AICPA Division of Firms guidelines would be acceptable, but the Board should receive a copy of the report and letter of comments.

Qualifications of Reviewers

- 1) Being a CPA or PA.
- 2) Being a partner or manager.
- 3) Having better than average technical skills in accounting principles and auditing standards and which are at least equivalent to those of the permit holder under review.
- 4) Having reasonable knowledge and experience with the type of reports and financial statements to be reviewed.
- 5) Being personally involved in at least five opinion audits per year.

History of Quality Review in South Dakota

Selection of Reviewer

The reviewer should be approved by the Board of Accountancy or program administrator; procedures should be written for notifying reviewers in advance and qualifications such as independence, specialized experience, size of reviewer's firm/reviewed firm, and conflict of interest should be considered. Evaluation, annual survey, and training of reviewers is necessary.

Procedures in Cases of Adverse Findings

The kinds of reports that should be issued would be termed unqualified or modified. A management letter should be provided in addition to the review report on modified reports and would be optional in unqualified reports. The Board of Accountancy should receive a synopsis of all modified reports. Accelerated reviews should cover only the areas of deficiency. It should be a Board decision as to whether disciplinary action should be public information and what action should be taken if a firm would refuse to be subjected to a review. The list of options, in case of repeated deficiencies, included: additional CPE requirements, further review into working papers, and a suggested minimum library list. It was decided "other sanctions as determined by the Board" should be added.

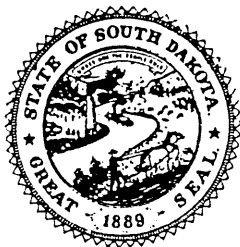
Based on these consensus, the Committee drafted proposed rules for the Board of Accountancy's consideration.

During the fiscal year beginning on July 1, 1986, the Board of Accountancy drafted and promulgated the final rules dealing with the implementation of Quality Review. These rules were adopted effective December 24, 1986.

The Quality Review program became effective July 1, 1987. The Board began preparing for its implementation early in 1987.

The quality review program encompassed a report review only for reviews performed for the calendar years of 1987, 1988 and 1989. Thereafter, reviews for the following years were to also encompass workpapers. At their July, 1990, Board meeting, a discussion was held regarding quality control. The Board decided to adopt the nine elements of quality control. The profession was moving in this general direction and to keep abreast of those changes, it was necessary for them to make this decision. The nine elements are required by Generally Accepted Auditing Standards. The rules became effective on January 20, 1991. Beginning with calendar year 1990, all reviews performed encompass reports, workpapers and quality control.

State of South Dakota



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Minnesota Board
of Accountancy

SOUTH DAKOTA BOARD OF ACCOUNTANCY RULES

CHAPTERS 20:37:05 THROUGH 20:37:13

Issued by
South Dakota Board of Accountancy

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reinstatement proceeding. Anticipated costs include legal fees, cost reporter costs, and service fees.

Upon receipt of the petition, the board shall schedule a formal hearing in accordance with the provisions of SDCL 1-26. The petitioner must demonstrate by clear and convincing evidence that he has the qualifications necessary for initial issuance of a certificate or permit, that his resumption of the practice of public accountancy will not be detrimental to the integrity and standing of the profession or subversive to the public interest, and that there is good cause for the board to modify its previous action. The board may not act on a subsequent petition until the expiration of at least one year from the effective date of the board's last ruling on the preceding petition.

Source: 11 SDR 83, effective December 23, 1984; 12 SDR 151, 12 SDR 155, effective July 1, 1986; 15 SDR 142, effective March 27, 1989; 17 SDR 103, effective January 20, 1991; 19 SDR 47, effective October 7, 1992.

General Authority: SDCL 36-20A-7, 36-20A-25.

Law Implemented: SDCL 36-20A-25.

Chapter 20:37:13 QUALITY REVIEW

SECTION

20:37:13:01	Definitions.
20:37:13:02	Requirement for review – Fee – Areas to be reviewed.
20:37:13:02.01	Quality review manual – Fees – Requirements.
20:37:13:03	Exemption from review.
20:37:13:04	Repealed.
20:37:13:05	New firms.
20:37:13:06	Equivalent reviews.
20:37:13:07	Selection of reviewer.
20:37:13:08	Qualifications of reviewer.
20:37:13:09	Conduct of review.
20:37:13:10	Results of review – Exit conference.
20:37:13:10.01	Report – Letter of comments.
20:37:13:10.02	Response to letter of comments.
20:37:13:10.03	Reviewer's submissions to board.
20:37:13:10.04	Firm's submissions to board.
20:37:13:10.05	Board's review of reports.
20:37:13:11	Confidentiality of reports.
20:37:13:12	Procedure in case of modified report.
20:37:13:13	Procedure in case of unqualified report.

20:37:13:01. Definitions. Terms used in this chapter mean:

- (1) "Unqualified report," a report issued as the result of a quality

review that describes no significant deficiencies in the professional standards set forth by §§ 20:37:11:07 and 20:37:11:08;

- (2) "Modified report," a qualified or adverse report issued as the result of a quality review that describes significant deficiencies in the professional standards set forth by §§ 20:37:11:07 and 20:37:11:08;
- (3) "Professional standards," professional standards set forth in §§ 20:37:11:07 and 20:37:11:08;
- (4) "Accounting and auditing practice," all auditing, accounting, review, and compilation services covered by generally accepted auditing standards, standards for accounting and review services, standards for accountants' services on prospective financial information, and Government Auditing Standards ("Yellow Book") issued by the U.S. General Accounting Office;
- (5) "Quality control system," the nine elements of quality control described in QC Section 10, "Statements on Quality Control Standards," and QC Section 10-1, "Interpretations of Quality Control Standards," published in AICPA Professional Standards, Volume 2, as of June 1, 1992;
- (6) "Year of review," the calendar year during which a quality review is to be conducted; in the case of an equivalent review, the fiscal or calendar year during which a quality review is to be conducted;
- (7) "Year under review," the calendar year prior to the year of review; in the case of an equivalent review, the fiscal or calendar year prior to the year of review.

Source: 13 SDR 77, effective December 28, 1986; 16 SDR 122, effective January 28, 1990; 17 SDR 103, effective January 20, 1991; 18 SDR 79, effective November 6, 1991; 19 SDR 47, effective October 7, 1992; 19 SDR 118, effective February 14, 1993.

General Authority: SDCL 26-20A-7.

Law Implemented: SDCL 36-20A-15.

References: Government Auditing Standards, July 1988 Revision, United States General Accounting Office. Copies may be viewed at the board's office or obtained from the United States General Accounting Office, Washington, DC 20548. Cost: \$3.50.

QC Section 10, "Statements on Quality Control Standards," and QC Section 10-1, "Interpretations of Quality Control Standards," pages 17.031 to 17.128, inclusive, AICPA Professional Standards, Volume 2 as of June 1, 1992, American Institute of Certified Public Accountants, Commerce Clearing House, 1992. Copies may be viewed at the board's office or obtained from American Institute of Certified Public Accountants, Harborside Financial Center, 201 Plaza III, Jersey City, N.J 07311. Cost: \$80.00 a set.

20:37:13:02. Requirement for review – Fee – Areas to be reviewed.
A licensed firm, as a condition to renewal of its firm permit pursuant to

SDCL 36-20A-7, must undergo a quality review in accordance with this chapter once every three years. The administrative fee for a quality review is \$125 and must be submitted to the board office by April 1 of the year of review. The quality review is limited to the firm's accounting and auditing practice and its related quality control system.

Source: 13 SDR 77, effective December 28, 1986; 15 SDR 142, effective March 27, 1989; 17 SDR 103, effective January 20, 1991; 19 SDR 118, effective February 14, 1993; SL 1993, ch 287, § 10, effective March 4, 1993.

General Authority: SDCL 36-20A-7.

Law Implemented: SDCL 36-20A-15.

20:37:13:02.01. Quality review manual – Fees – Requirements.

Firms applying for a quality review under this chapter are required to purchase the South Dakota Quality Review Manual and any subsequent annual updates. Firms applying under the equivalent review provisions in § 20:37:13:06 are exempt from purchasing the manual or updates. The fee for a new Quality Review Manual is \$150 and updates are \$50.

Source: 19 SDR 118, effective February 14, 1993.

General Authority: SDCL 36-20A-7.

Law Implemented: SDCL 36-20A-15.

Note: The Quality Review Manual published by the South Dakota Board of Accountancy contains checklists and forms used in conducting quality reviews. It can be obtained at a South Dakota Board of Accountancy Quality Review Seminar or it can be purchased at the South Dakota Board of Accountancy, 301 E. 14th Street, Suite 200, Sioux Falls, South Dakota, 57104. This manual is updated annually.

20:37:13:03. Exemption from review. A firm is exempt from the quality review requirement set forth in § 20:37:13:02 if it annually represents to the board that it does not engage in the financial reporting area of practice, including audits, reviews, compilations, and accounting services on prospective financial information; that it does not intend to engage in such a practice during the following year; and that it will immediately notify the board in writing if it engages in such a practice.

The representation shall be made in writing, under oath, and upon forms provided by the board. They shall be made annually at the time the firm applies for renewal of its firm permit.

If a firm under exemption notifies the board that it has engaged in the financial reporting area of practice, it must undergo a quality review during the first calendar year after its initial acceptance of an engagement.

Source: 13 SDR 77, effective December 28, 1986; 17 SDR 103, effective January 20, 1991.

General Authority: SDCL 36-20A-7.

Law Implemented: SDCL 36-20A-15.

20:37:13:04. Firm selection and notification. Repealed

Source: 13 SDR 77, effective December 28, 1986; repealed, 15 SDR 142, effective March 27, 1989.

20:37:13:05. New firms. A new firm, as a condition to renewal of its firm permit, must undergo a quality review during the first calendar year after it has been engaged in the practice of public accountancy for one full calendar year. After the initial review, the firm shall be reviewed every three years thereafter.

A new firm is a firm that has not been previously licensed in this state or has not had a quality review completed in the three-year period prior to application. It does not include the following:

- (1) A firm that has been previously licensed and changes its name or the legal form of its practice, but retains the same practice;
- (2) A new partnership formed by two former sole proprietors who are existing permit holders who were already selected for quality review. The quality review of the new firm shall be conducted in the later of the years for which each of the former sole proprietors was selected;
- (3) A partnership that is dissolved with each individual taking clients from the partnership. The quality review for the new firm of each permit holder remains in the same year to which the original partnership was assigned;
- (4) A partnership that is dissolved with one partner taking all of the clients. The quality review for the permit holder taking over the existing business remains in the year to which it was originally assigned.

Source: 13 SDR 77, effective December 28, 1986; 16 SDR 122, effective January 28, 1990.

General Authority: SDCL 36-20A-7.

Law Implemented: SDCL 36-20A-15.

20:37:13:06. Equivalent reviews. If a firm undergoes an equivalent quality review during its three-year review cycle, it may request that the board accept the review as fulfilling the requirements of § 20:37:13:02. A quality review is considered equivalent if it is conducted by the American Institute of Certified Public Accountants, a state licensing board, or an accounting association or society in accordance with the review standards set forth in §§ 20:37:13:09 and 20:37:13:10.05, inclusive.

The request must be submitted on forms provided by the board and shall set forth the name of the reviewing body, the date of the review, an industry profile, information on firm composition, evidence establishing that the reviewing body meets the qualifications of § 20:37:13:08, and

any other information requested by the board. If the review has not been completed, the reviewer must agree to retain all materials associated with the quality review until notification from the board of the acceptance of the review. The request for acceptance of an equivalent review or the notification of selection of reviewer form must be received by the board at the board's office or postmarked by March 1 of the year the firm is scheduled by the board for quality review.

If the board approves the request for an equivalent review, the firm subject to review shall submit to the board the reviewer's report; the letter of comments, if any; the reviewed firm's response to the letter of comments, if any; the final letter of approval; and a description of the status of any disciplinary action prescribed by the particular reviewing body. If the equivalent quality review was completed prior to the firm's request, the firm shall submit the required information to the board within 30 days after the date on the board's letter confirming the request. If the equivalent quality review will be completed after the firm receives board confirmation of the request, the firm shall submit the required information within 30 days after the date of the final letter of approval from the reviewing body.

Following receipt of the required information, the board shall proceed in accordance with § 20:37:13:12 or 20:37:13:13.

Source: 13 SDR 77, effective December 28, 1986; 15 SDR 142, effective March 27, 1989; 16 SDR 122, effective January 28, 1990; 17 SDR 103, effective January 20, 1991; 18 SDR 79, effective November 6, 1991; 19 SDR 47, effective October 7, 1992; 19 SDR 118, effective February 14, 1993.

General Authority: SDCL 36-20A-7.

Law Implemented: SDCL 36-20A-15.

20:37:13:07. Selection of reviewer. A firm selected for review shall engage an individual to conduct the quality review, subject to approval by the board. By March 1 of the year of review, a firm subject to review shall submit the name of the individual who will conduct the review to the board in writing, on forms provided by the board. The firm must provide evidence establishing that the reviewer meets the qualifications set forth in § 20:37:13:08.

A firm selected for review shall submit an industry profile and information on firm composition on forms provided by the board by March 1 of the year of review.

If a firm selected for review fails to notify the board by March 1 of its selection of reviewer by filing the selection of reviewer form or the application for acceptance of equivalent review, the firm waives the right to select a reviewer or have input in the selection of a reviewer. The board shall select an individual to conduct the review and notify the firm of the selection by April 1. The firm subject to review, whether it selects

the reviewer or not, must submit an industry profile by March 1, engage the reviewer, and file a copy of the letter or contract of engagement with the board by May 15.

Source: 13 SDR 77, effective December 28, 1986; 16 SDR 122, effective January 28, 1990; 17 SDR 103, effective January 20, 1991; 18 SDR 79, effective November 6, 1991; 19 SDR 47, effective October 7, 1992.

General Authority: SDCL 36-20A-7.

Law Implemented: SDCL 36-20A-15.

Cross-Reference: Requirement for review – Areas to be reviewed, § 20:37:13:02.

20:37:13:08. Qualifications of reviewer. An individual selected to conduct a review must have the following minimum qualifications:

- (1) Be licensed to practice as a certified public accountant or public accountant by the licensing board of any state;
- (2) Have knowledge and experience with the type of reports and financial statements to be reviewed, including experience in supervision of the preparation of such reports and statements;
- (3) Be independent of the firm under review;
- (4) Have no conflict of interest;
- (5) Be familiar with all specialized services in the area of auditing and accounting provided by the firm subject to review;
- (6) Be able to demonstrate that he is familiar with the procedure for conducting a quality review in accordance with the standards set forth in §§ 20:37:13:09 and 20:37:13:10;
- (7) Provide evidence on forms provided by the board that his firm received an unqualified report during the past three years or a certified true statement that his firm was not subject to review;
- (8) Submit an industry profile on forms provided by the board;
- (9) Provide evidence on forms provided by the board that he is familiar with operations in a firm comparable to the size of the firm he desires to review; and
- (10) Attend a quality review seminar sponsored by the board or an equivalent seminar sponsored by the American Institute of Certified Public Accountants, another state board, or another society.

Members of the board and members of their firm may not conduct a quality review; however, members of their firm may conduct equivalent reviews in accordance with § 20:37:13:06.

Source: 13 SDR 77, effective December 28, 1986; 17 SDR 103, effective January 20, 1991; 18 SDR 79, effective November 6, 1991.

General Authority: SDCL 36-20A-7.

Law Implemented: SDCL 36-20A-15.

20:37:13:09. Conduct of review. The quality review shall be conducted on-site unless the board gives prior approval for off-site review. In granting approval for off-site review, the board shall consider firm size and makeup, the number and types of engagements, distances involved, and prior review by another agency.

The quality review shall be conducted in accordance with the following:

- (1) A review shall cover a firm's accounting and auditing practice and its related quality control system;
- (2) The review shall be conducted between May 1 and October 31 of the year of review unless otherwise agreed by the board and the firm subject to review;
- (3) The reviewer shall select the engagements to be reviewed. The engagements shall cover between five and ten percent of the firm's accounting and auditing practice hours. If the reviewed firm has one or more audits conducted pursuant to the Government Auditing Standards or the Employee Retirement Income Security Act of 1974, at least one of those engagements must be selected. Because of the special considerations involved, greater weight shall be given to selecting the following types of engagements:
 - (a) Those in which there is a significant public interest, such as financial institutions and brokers or dealers in securities; and
 - (b) Those which are large, complex, or high risk or that are the reviewed firm's initial audits of clients;
- (4) The review shall be limited to the reviewed firm's quality control system and the accounting and auditing engagements with client year ends dated within the year under review;
- (5) The reviewer shall use checklists provided by the board as a basis for performing the review. A separate checklist shall be used for the quality control system, audits, reviews, and compilations. The checklists shall include questions for the reviewer to answer and must provide sufficient information for the board to determine whether the firm under review complies with the standards and principles in §§ 20:37:11:07 and 20:37:11:08; and
- (6) The firm under review shall submit to the reviewer the prior quality review report, the letter of comments, if any; the reviewed firm's response to the letter of comments, if any; the final letter of approval; and any board or review committee performance requirements.

Source: 13 SDR 77, effective December 28, 1986; 15 SDR 142, effective March 27, 1989; 17 SDR 103, effective January 20, 1991; 18 SDR 79, effective November 6, 1991; 19 SDR 47, effective October 7, 1992.

General Authority: SDCL 36-20A-7.

Law Implemented: SDCL 36-20A-15.

Note: The Quality Review Manual published by the South Dakota Board of Accountancy contains checklists and forms used in conducting quality review that meet the requirements of this section. It can be obtained at a South Dakota Board of Accountancy Quality Review Seminar or it can be purchased at the South Dakota Board of Accountancy, 301 E. 14th Street, Suite 200, Sioux Falls, South Dakota 57104. This manual is updated annually.

20:37:13:10. Results of review – Exit conference. A reviewer may issue an unqualified, qualified, or adverse opinion as to whether the reports, work papers, and quality control system reviewed comply with the standards and principles in §§ 20:37:11:07 and 20:37:11:08 based on the evidence he obtained in his review.

The reviewer shall conduct an exit conference with representatives of the reviewed firm on the last day of the field work. The board may grant permission to hold the exit conference at a later date if the reviewer contacts the board by the date the exit conference is scheduled. The reviewer shall submit copies of the quality review completion notification form to the board on the day the exit conference is completed.

Source: 13 SDR 77, effective December 28, 1986; 15 SDR 142, effective March 27, 1989; transferred to §§ 20:37:13:10.01, 20:37:13:10.02, and 20:37:13:10.04, 17 SDR 103, effective January 20, 1991.

General Authority: SDCL 36-20A-7.

Law Implemented: SDCL 36-20A-15.

20:37:13:10.01. Report – Letter of comments. Within 30 days after the date of the exit conference, the reviewer shall issue a written report and, if applicable, a letter of comments to the reviewed firm.

The report and letter shall be addressed to the proprietor, partners, stockholders, or officers of the reviewed firm and shall be dated as of the date of the exit conference. The report must include the following:

- (1) The year covered by the review;
- (2) A statement of the scope of the review;
- (3) A description of the general characteristics of a system of quality control; and
- (4) The reviewer's opinion. If the opinion is qualified or adverse, the report must include a description of the reasons for the modification.

If the reviewer finds deficiencies, he shall issue to the firm under review a letter of comments outlining the deficiencies and recommending action to correct the deficiencies. The board may waive this provision upon the request of the reviewer.

Source: 13 SDR 77, effective December 28, 1986; 15 SDR 142, effective March 27, 1989; transferred from § 20:37:13:10, 17 SDR 103, effective January 20, 1991; 18 SDR 79, effective November 6, 1991.

General Authority: SDCL 36-20A-7.

20:37:13:10.02. Response to letter of comments. The firm under review shall issue a response to a letter of comments. The letter of response shall contain the following:

- (1) A statement addressing each deficiency in the reviewer's letter of comments;
- (2) A statement of agreement or disagreement with the findings of the reviewer. The firm must provide reasons if it disagrees with the findings;
- (3) A statement of agreement or disagreement with the corrective action recommended by the reviewer; and
- (4) A schedule for correcting deficiencies.

Source: 13 SDR 77, effective December 28, 1986; 15 SDR 142, effective March 27, 1989; transferred from § 20:37:13:10, 17 SDR 103, effective January 20, 1991.
General Authority: SDCL 36-20A-7.
Law Implemented: SDCL 36-20A-15

20:37:13:10.03. Reviewer's submissions to board. The reviewer shall submit copies of the following to the board office within 30 days after the exit conference:

- (1) The reviewer's checklist;
- (2) The summary review memorandum;
- (3) The quality review work program guidelines;
- (4) The engagement checklists;
- (5) The matters for further consideration;
- (6) The summaries of the matters for further consideration;
- (7) The summaries of unresolved "no" answers in engagement checklists not resulting in a matter for further consideration;
- (8) The exit conference summary; and
- (9) The reviewed firm's letter representing its compliance with requirements for the quality review.

Source: 17 SDR 103, effective January 20, 1991.
General Authority: SDCL 36-20A-7.
Law Implemented: SDCL 36-20A-15.

20:37:13:10.04. Firm's submissions to board. The firm under review shall submit copies of the following to the board within 60 days after completion of the exit conference or by November 30 of the year of review, whichever comes first:

- (1) The reviewer's report;

- (2) Any required checklists;
- (3) The letter of comments, if any;
- (4) The firm's response to the letter of comments, if any; and
- (5) The statement for services rendered by the reviewer.

Source: 13 SDR 77, effective December 28, 1986; 15 SDR 142, effective March 27, 1989; transferred from § 20:37:13:10, 17 SDR 103, effective January 20, 1991; 19 SDR 47, effective October 7, 1992.
General Authority: SDCL 36-20A-7.
Law Implemented: SDCL 36-20A-15.

20:37:13:10.05. Board's review of reports. After receipt of documentation from the reviewer and the firm under review, the board shall review the file and proceed with § 20:37:13:12 or 20:37:13:13. If the board determines that the firm under review does not comply with §§ 20:37:11:07 and 20:37:11:08, the board may require the reviewer to recall and reissue his report.

If the board determines that the reviewer has not issued the report or letter of comments in accordance with §§ 20:37:13:10 to 20:37:13:10.05, inclusive, the board shall return the report or the letter of comments, or both, to the reviewer for correction. The board may deny an individual the right to continue as a qualified reviewer if a subsequent report and any letter of comments are issued containing the errors he was previously notified to correct.

The reviewer shall destroy all materials associated with the quality review upon notification from the board of acceptance of the review.

Source: 17 SDR 103, effective January 20, 1991; 18 SDR 79, effective November 6, 1991.
General Authority: SDCL 36-20A-7.
Law Implemented: SDCL 36-20A-15.

20:37:13:11. Confidentiality of reports. The board shall treat the reports of the reviewing firm and all records submitted to that firm by the firm subject to review as confidential information and shall not disclose such information to any persons other than staff members, legal counsel, and other persons retained by the board to assist it in fulfilling its responsibilities under SDCL 36-20A and this article.

If a firm under review becomes the subject of a disciplinary proceeding pursuant to the provisions of SDCL 36-20A-20 and 36-20A-21, the board may make such information public in accordance with the provisions of those statutes.

Source: 13 SDR 77, effective December 28, 1986.
General Authority: SDCL 36-20A-7.
Law Implemented: SDCL 36-20A-15, 36-20A-21.

Cross-Reference: Confidential client information, § 20:37:11:10.

20:37:13:12 Procedure in case of modified report. If the report is designated modified, the board may attempt to have the firm subject to review correct the deficiencies through a consent agreement. The consent agreement shall set forth a plan and schedule for correction of the deficiencies. The consent agreement may include the following:

- (1) A requirement that the deficiencies be corrected within a specified time period;
- (2) A requirement that the firm undergo a quality review during the calendar year following the date designated for correction of the deficiencies;
- (3) A requirement that the members of the firm complete continuing education in the areas of deficiency in addition to the continuing education hours required by SDCL 36-20A-12;
- (4) A requirement that the firm maintain a minimum library of source materials; and
- (5) Any other requirements that will effectuate the purpose of this chapter and SDCL 36-20A.

If the board and the firm are not able to reach a consent agreement in regard to a plan and schedule for correction of the deficiencies, the board may then proceed in accordance with SDCL 36-20A-20 and 36-20A-21.

Source: 13 SDR 77, effective December 28, 1986; 17 SDR 103, effective January 20, 1991; 19 SDR 47, effective October 7, 1992.

General Authority: SDCL 36-20A-7.

Law Implemented: SDCL 36-20A-15, 36-20A-21.

Cross-Reference: Results of review, §§ 20:37:13:10 to 20:37:13:10.05, inclusive.

20:37:13:13. Procedure in case of unqualified report. If the report is designated unqualified, the board may take no further action or it may request additional information or response from the firm under review or reviewer to support or clarify the unqualified report. If the firm fails to respond in the manner requested by the board, the board may proceed in accordance with the provisions of SDCL 36-20A-20 and 36-20A-21.

Source: 17 SDR 103, effective January 20, 1991; 18 SDR 79, effective November 6, 1991.

General Authority: SDCL 36-20A-7.

Law Implemented: SDCL 36-20A-15, 36-20A-21.

Cross-Reference: Results of review, §§ 20:37:13:10 to 20:37:13:10.05, inclusive.