



THE STATE EDUCATION DEPARTMENT / THE UNIVERSITY OF THE STATE OF NEW YORK / ALBANY, NY 12234

**TO:** The Professional Practice Committee

**FROM:** Frank Muñoz

**SUBJECT:** Proposed Amendment to the Regulations of the Commissioner of Education Relating to the Implementation of a Mandatory Quality Review Program in Public Accountancy

**DATE:** November 30, 2010

**STRATEGIC GOAL:** Goal 3

**AUTHORIZATION(S):**

### **Summary**

#### **Issue for Decision**

Should the Board of Regents add a new section 70.10 to the Regulations to the Commissioner of Education relating to establishing a mandatory quality review program in public accountancy?

#### **Reason(s) for Consideration**

Required by law.

#### **Proposed Handling**

The proposed amendment is being presented for both regular adoption and emergency adoption at the December 2010 Regents meeting. A statement of facts and circumstances which necessitate emergency action is attached.

#### **Procedural History**

A Notice of Proposed Rule Making concerning the proposed amendment was published in the State Register on July 28, 2010. The proposed amendment was modified to reflect changes made during the comment period and a Notice of Revised Rule Making was published in the State Register on October 6, 2010. Supporting materials for the proposed amendment are available from the Secretary to the Board of

Regents. The proposed amendment was discussed by the Professional Practice Committee at the November 2010 Regents meeting.

### Background Information

The purpose of the proposed amendment to the Regulations of the Commissioner of Education is to implement section 7410 of Education Law, which was added by Chapter 651 of the Laws of 2008. Section 7410 requires certain public accounting firms to undergo periodic quality reviews and requires the Department to promulgate regulations to implement the mandatory quality review program.

The new law strongly enhances the protection of clients and the general public by requiring certain public accounting firms to undergo a quality review of the firm's attest services as a condition to renewal of registration. Sole proprietorship firms or firms with two or fewer accounting professionals, including certified public accountants or public accountants, or any combination thereof, are exempt from this requirement, unless they provide attest services for a governmental entity in New York State or attest services required to be performed pursuant to New York State law.

The proposed regulation establishes a mandatory quality review program in New York and defines those public accounting firms that must participate in the program. The regulation also establishes and defines the responsibilities of a Quality Review Oversight Committee to oversee the program and to perform certain functions; defines the approval process for sponsoring organizations that administer the quality reviews, including the approval and assignment of reviewers and review teams; establishes standards to be used when conducting a quality review; establishes a document retention policy; requires the submission of the public version of a public accounting firm's Public Company Accounting Oversight Board inspection report; and provides for the acceptance of equivalent quality review reports conducted outside of New York.

Staff of the State Education Department worked with the State Board for Public Accountancy to develop the proposed amendments.

Following publication in the State Register, the proposed amendment was modified in response to several comments received during the public comment period. Amendments were made to subdivisions (b)(5) and (7), (c)(5), and (f) of section 70.10 of the Regulations of the Commissioner for purposes of clarity and to conform to professional standards. Subdivision (f)(3)(i)(a)(1) was amended to clarify the qualifications for team captains who perform different types of quality review services.

### Recommendation

VOTED: That section 70.10 of the Regulations of the Commissioner of Education be added, as submitted, effective January 5, 2011.

VOTED: That section 70.10 of the Regulations of the Commissioner of Education be added, as submitted, effective December 17, 2010, as an emergency action upon a finding by the Board of Regents that such action is necessary for the preservation of the

general welfare to timely implement the provisions of Chapter 651 of the Laws of 2008, by ensuring that the proposed amendment is in effect no later than January 1, 2011.

Timetable for Implementation

If adopted at the December meeting, the emergency rule will become effective on December 17, 2010 and the permanent rule will be effective on January 5, 2011.

AMENDMENT TO THE REGULATIONS OF THE COMMISSIONER OF EDUCATION

Pursuant to sections 207, 6504, 6506, 6507 and 7410 of the Education Law

The Regulations of the Commissioner of Education are amended, effective  
December 17, 2010, by the addition of a new section 70.10 to read as follows:

§70.10 Mandatory quality review program.

(a) Establishment of Quality Review Program. Except as otherwise provided in this section, pursuant to section 7410 of the Education Law, effective January 1, 2012, the Department establishes a mandatory quality review program, requiring all applicants seeking a firm registration or a renewal of such registration, other than sole proprietorships or firms with two or fewer accounting professionals, to participate in a quality review of the firm's attest services.

(b) Definitions. For purposes of this section:

(1) Accounting professional means a certified public accountant, as defined in Education Law section 7401-a(2), or a public accountant, as defined in Education Law section 7401-a(6).

(2) Quality review report means a formal report issued by a reviewer and accepted by a sponsoring organization in accordance with this section.

(3) Review means a review conducted under the mandatory quality review program prescribed in this section.

(4) Review team means an individual or individuals assisting the team captain in conducting a review under this section.

(5) Reviewer means the team captain or a member of a review team, if any, approved by the sponsoring organization to conduct a review.

(6) Sponsoring organization means an entity, located in the state of New York, approved by the department in accordance with subdivision (e) of this section to oversee and facilitate quality reviews performed by a reviewer in accordance with the provisions of this section.

(7) Team captain means a person approved by a sponsoring organization to supervise and conduct a review under this section and to be responsible for the work performed by the review team.

(c) Participation in Mandatory Quality Review Program.

(1) Pursuant to section 7410 of the Education Law, an applicant seeking a renewal of its firm registration, with the exception of a sole proprietorship firm or a firm with two or fewer accounting professionals, that performs attest services, shall undergo, no more frequently than once every three years, except pursuant to a disciplinary action brought under section 7408 of the Education Law, a quality review of the firm's attest services in accordance with the provisions of this section.

(2) Any firm, including a firm organized as a sole proprietorship or a firm with two or fewer accounting professionals, that performs attest services for any New York State or municipal department, board, bureau, division, commission, committee, public authority, public corporation, council, office, or other governmental entity performing a governmental or proprietary function for New York State or any one or more municipalities

thereof, or performs attest services specifically required to be performed pursuant to New York State law shall be required to undergo an external peer review, in conformity with Generally Accepted Government Auditing Standards issued by the Comptroller General of the United States.

(3) Except as otherwise provided in paragraph (2) of this subdivision, sole proprietorship firms or firms with two or fewer accounting professionals may voluntarily undergo a quality review.

(4) Any firm registered with the department that is not required to participate in a quality review program under this section shall submit an annual written notification of the basis for such non-participation as part of the firm's submission of its annual report as required in Education Law section 7408(3)(e).

(5) Any firm that begins providing attest services as described in Education Law section 7401-a or otherwise becomes subject to mandatory participation in the quality review program shall notify the department of its change in status within 30 days and provide the department with evidence of enrollment in an acceptable quality review program within one year of either the date of the firm's initial registration or the firm's initial performance of services requiring a quality review under this section, and the firm shall have a quality review completed within 18 months of the date such services were first provided.

(d) Quality Review Oversight Committee. The department establishes a Quality Review Oversight Committee (QROC) to oversee the mandatory quality review program and to perform the functions described in paragraph (2) of this subdivision.

(1) Composition of Quality Review Oversight Committee. The QROC shall be comprised of five members appointed by the Board of Regents. Members of the QROC shall be appointed by the Board of Regents for five-year terms, except that the terms of those first appointed shall be arranged so that as nearly as possible an equal number of such terms shall terminate annually. A vacancy occurring during a term shall be filled by an appointment by the Board of Regents for the unexpired term. Members of the QROC must be licensed certified public accountants in New York State and hold current registrations with the department, and may not be members of the state board for public accountancy or one of its committees. QROC members shall be compensated in accordance with Education Law section 6506(4).

(2) Responsibilities of the QROC. The QROC shall:

(i) receive and approve the quality review administration plans from entities applying to be sponsoring organizations in accordance with subdivision (e) of this section;



(ii) at least annually monitor sponsoring organizations to provide reasonable assurance that the sponsoring organization is providing an acceptable level of oversight over reviewers, review teams and firms participating in the quality review program administered by the sponsoring organization and to ensure that such reviews are conducted and reported on in accordance with the quality review standards set forth in subdivision (i) of this section;

(iii) inform the department of any issues and/or problems relating to the quality review program which may require the department's intervention;

(iv) annually report to the department as to whether each sponsoring organization meets the standards necessary to continue as an approved sponsoring organization;

(v) annually assess the effectiveness of the quality review program;

(vi) annually report to the department on any recommended modifications to the quality review program;

(vii) review each quality review report submitted by a firm, as part of its registration or renewal of its registration, to determine whether the firm is complying with applicable professional standards.

(a) If the results of QROC's review indicate that a firm is complying with applicable professional standards and has received a quality review report issued by a reviewer approved by the department without deficiencies, the QROC shall recommend to the department that it accept the firm's quality review report.

(b) If the results of the QROC's review reveal that a firm's quality review report from a reviewer approved by the department includes deficiencies, or indicates that the

firm was not in compliance with applicable professional standards, and if the QROC finds that the report warrants disciplinary action, the QROC may refer the firm to the Office of Professional Discipline pursuant to Education Law section 6510; and

(viii) ensure that any documents received from a firm or reviewer, sponsoring organization or entity administering peer review outside the state of New York shall be confidential and not constitute a public record and shall not be subject to disclosure under articles six and six-A of the Public Officers Law. However, when any such document is admitted into evidence in a hearing held by the department, it shall then be a public record subject to disclosure under articles six and six-A of the Public Officers Law.

(e) Approval of sponsoring organizations. To qualify as a sponsoring organization, an entity shall submit a quality review administration plan to the department for review and approval by the QROC. The plan of administration shall:

(1) establish committees, as needed, and provide assurances that there is sufficient professional staff for the operation of the quality review program overseen by the sponsoring organization;

(2) provide assurances that the sponsoring organization will notify firms and reviewers participating in the quality review program of the latest developments in quality review standards and the most common deficiencies in quality reviews conducted by the sponsoring organization;

(3) establish procedures for resolving any disagreement between the firm and the reviewer which may arise out of the performance of a quality review;

(4) acknowledge that the sponsoring organization is subject to evaluations by the department or the QROC to periodically assess the effectiveness of the quality review program under its charge;

(5) establish procedures to evaluate and document the performance of each reviewer, and to disqualify a reviewer who does not meet the standards for quality reviews set forth in subdivision (i) of this section;

(6) establish procedures such that the sponsoring organization will provide the QROC timely access to quality review reports;

(7) establish procedures to ensure that any documents received from a firm or reviewer shall be confidential and not constitute a public record and shall not be subject to disclosure under articles six and six-A of the Public Officers Law. However, when any such document is admitted into evidence in a hearing held by the Department, it shall then be a public record subject to disclosure under articles six and six-A of the Public Officers Law; and

(8) provide for annual reports to the QROC on the results of the sponsoring organization's quality review program, which shall include information on completed reviews, including the most common deficiencies noted by reviewers and, with respect to the quality review program:

(i) the number of reviews conducted;

(ii) the number of firms found to be performing and reporting in compliance with applicable professional standards;

(iii) the number of firms found to have some deficiencies in complying with applicable professional standards; and

(iv) the number of firms found not to be in compliance with applicable professional standards.

(f) Approval of team captains and review teams.

(1) Each approved sponsoring organization shall provide a list of reviewers to the department, and from such lists the department will develop a roster of approved reviewers for the quality review program.

(2) Each approved sponsoring organization shall develop and implement procedures to assure that each review team member:

(i) is licensed or otherwise authorized to practice public accountancy in any state;  
and

(ii) possesses knowledge of professional standards applicable to the attest practice or other specialized areas of practice to be reviewed, including recent experience in, and knowledge about, the rules and regulations appropriate to the industries of the engagements the individual will be reviewing.

(3) Each approved sponsoring organization shall develop and implement procedures to assure that each team captain:

(i) is licensed or otherwise authorized to practice public accountancy in any state;  
and

(ii) meets the following competencies prior to commencing a quality review:

(a) (1) each team captain performing a quality review of a firm's system of quality control over its attest services, shall within the last five years, have experience performing attest services on behalf of a firm as a sole proprietor, partner of a partnership or limited liability partnership, member of a limited liability company or shareholder of a professional service corporation;

(2) each team captain performing a quality review to evaluate that a firm's engagements were performed and reported in conformity with applicable professional standards, shall within the last five years, have experience performing attest services on behalf of a firm as a sole proprietor, partner of a partnership or limited liability

partnership, member of a limited liability company or shareholder of a professional service corporation, manager or person with equivalent supervisory responsibilities;

(b) has either:

(1) completed at least 16 hours of introductory training acceptable to the department relating to the performance of quality reviews if the team captain will be issuing a report expressing an opinion on the firm's system of quality control; or

(2) has completed at least 8 hours of introductory training acceptable to the department relating to the performance of quality reviews if the team captain will be issuing a report that only evaluates engagements submitted for review without expressing an opinion on the firm's system of quality control;

(c) subsequent to the team captain's completion of an introductory reviewer training course pursuant to clause (b) of this subparagraph and within each successive triennial period as a team captain, the team captain shall complete a minimum of eight hours of reviewer training acceptable to the department relating to the performance of quality reviews; and

(d) possesses knowledge of professional standards applicable to the attest practice to be reviewed, including recent experience in, and knowledge about, the rules and regulations appropriate to the industries of the engagements the individual will be reviewing.

(g) Removal from roster of qualified reviewers. The department may, upon notice and with the opportunity to respond, remove a reviewer from the roster of approved reviewers for:

(i) failure to meet the requirements of subdivision (f) of this section; or

(ii) being subject to any final disciplinary action taken against him or her by a licensing or disciplinary authority of any jurisdiction with respect to any professional

license or having any charges of professional misconduct pending against him or her in any other jurisdiction.

(h) Effect of substandard reviews. Any firm that receives a quality review report indicating that the firm has failed to design a system of quality control over its attest services or comply with its system of quality control over its attest services, or that receives a quality review report indicating that the firm has failed to perform and report on engagements in conformity with applicable professional standards in material respects, may be referred by the QROC for disciplinary action under Education Law section 6510.

(i) Standards for quality reviews.

(1) Any sponsoring organization that administers quality reviews under this section and/or any reviewer performing a quality review under this section shall utilize standards for performing and reporting on quality reviews promulgated by a recognized national accountancy organization whose standards are generally accepted by other regulatory authorities in the United States and are acceptable to the department, including but not limited to the American Institute of Certified Public Accountants Standards for Performing and Reporting on Peer Reviews.

(2) In addition to the standards described in paragraph (1) of this subdivision, for any firm undergoing a review of its system of quality control, the review team shall review the firm's continuing education records on a sample basis and consider whether the records demonstrate that the licensee in the firm who supervised attest services or signed or authorized someone to sign the accountant's report on the financial statements of a client on behalf of the firm has met the competency requirements set forth in professional standards for such services, and in paragraph (13) of subdivision (a) of section 29.10 of the Rules of the Board of Regents.

(j) Access to results of quality reviews.

(1) Any firm required to participate in the mandatory quality review program pursuant to section 7410 of the Education Law shall submit the following documents, as applicable, to the department:

(i) a quality review report issued by a reviewer approved by the department;

(ii) the firm's letter of response;

(iii) an acceptance letter from a sponsoring organization;

(iv) letter(s) signed by the firm accepting the documents with the understanding that the firm agrees to take any actions required by the reviewer; and

(v) a letter from the sponsoring organization notifying the reviewed firm that required actions have been appropriately completed.

(2) Quality review documents required in subparagraphs (i) through (iii) of paragraph (1) of this subdivision shall be made available to the department via a website address provided by the sponsoring organization within thirty days of the date on the acceptance letter from the sponsoring organization. The quality review document required in subparagraph (iv) of paragraph (1) of this subdivision shall be made available to the department within thirty days of the date that the firm signs such letter. The document required in subparagraph (v) of paragraph (1) of this subdivision shall be made available to the department within thirty days of the date of the letter from the sponsoring organization notifying the reviewed firm that the required actions have been appropriately completed. If a sponsoring organization cannot provide access to the quality review documents required in subparagraphs (i) to (v) of paragraph (1) of this subdivision via a website, the firm shall provide copies of the quality review documents by mail or facsimile within ten days of receipt of the applicable document, except for the quality review document required in subparagraph (iv) of paragraph (1) of this

subdivision which shall be submitted within ten days of the date the firm signs such letter.

(3) Equivalent quality review reports submitted in accordance with subdivision (m) of this section shall be made available to the department via a website provided by the entity administering the quality review, in accordance with the requirements of paragraph (2) of this subdivision. If the entity that administered the quality review cannot provide access to the equivalent quality review documents via a website, the firm shall provide copies of the equivalent quality review documents by mail or facsimile in accordance with the requirements of paragraph (2) of this subdivision.

(k) Retention of documents.



(1) Each reviewer and sponsoring organization, as applicable, shall maintain all documentation necessary to establish that each review conformed to the review standards of the relevant review program, including the review working papers, copies of the review report, and any correspondence indicating the firm's concurrence, non-concurrence, and any proposed remedial actions and any related implementation.

(2) The documents described in paragraph (1) of this subdivision shall be retained by the reviewer for a period of time corresponding to the retention period of the sponsoring organization, and shall be made available upon request of the QROC. In no event shall the retention period be less than 120 days from the date of acceptance of the review by the sponsoring organization.

(l) Public Company Accounting Oversight Board inspections. In addition to the review required under subdivision (c) of this section, any firm that undergoes an inspection conducted by the Public Company Accounting Oversight Board (PCAOB) as required under the Sarbanes-Oxley Act of 2002 shall submit to the department a copy of the public version of its most recent inspection report within ten days of a receipt of the notice of completion from the PCAOB.

(m) Equivalent quality review reports. The department may, in its discretion, accept from a firm a review report which the department deems to be the substantial equivalent of a quality review report issued under this section. A review report will be deemed substantially equivalent provided such reviews are conducted and reported on in accordance with the quality review standards set forth in subdivision (i) of this section.

Peer reviews administered by entities located outside the state of New York acceptable to the department and any affiliated administering entities may be accepted as substantially equivalent of a quality review report issued under this section.