

RESEARCH IN
ACCOUNTING REGULATION

Editor: GARY JOHN PREVITS
Associate Editors: LARRY M. PARKER
ROBERT ESKEW

Volume 8 • 1994

F23
19:94(9)

RESEARCH IN ACCOUNTING REGULATION

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江苏工业学院图书馆
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VOLUME 8 • 1994



JAI PRESS INC.

Greenwich, Connecticut

London, England

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55 Old Post Road, No. 2
Greenwich, Connecticut 06830

JAI PRESS LTD.
The Courtyard
28 High Street
Hampton Hill
Middlesex, TW12 1PD
England

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ISBN: 1-55938-402-6

Manufactured in the United States of America

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Volume 8 • 1994

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MAIN PAPERS

Wanda A. Kunda

During the past decade, the field of organizational behavior has experienced a significant increase in the number of studies published in the area of organizational behavior. This increase has been largely due to the fact that the field has become a part of the mainstream of organizational behavior research. The research in this area has been largely focused on the study of organizational behavior, and the results of this research have been largely positive. The research in this area has been largely focused on the study of organizational behavior, and the results of this research have been largely positive.

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AN EXPLORATORY CONTENT ANALYSIS OF TERMINOLOGY IN PUBLIC ACCOUNTING FIRMS' RESPONSES TO AICPA PEER REVIEWS

Wanda A. Wallace and Karen S. Cravens

ABSTRACT

Despite peer reviewers' issuance of an unqualified report, the AICPA oversight committee has frequently called for particular voluntary actions to be taken by the reviewee. Related communications between the peer reviewee and the AICPA become a part of the public file. This research explores the nature of such public files through content analysis, both in a computerized form and in a more informal subjective analysis form. All non-boilerplate AICPA cover letters accompanying SEC Practice Section (SECPS) public files for the period from 1980 through the first quarter of 1986 are the population

Research in Accounting Regulation, Volume 8, pages 3-32.

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ISBN: 1-55938-402-6

The findings suggest that the AICPA cover letter and accompanying reviewee's response, though much shorter than the peer review report and related letter of comments, are reasonable surrogates for such detail in the public files. Of interest in evaluating the regulatory process is the finding that reviewees' response letters that have been removed by the AICPA from the public files to "prevent any confusion on the part of the public as to the purpose of such letters" were far more likely to contain competency-related findings.

The public files for the SEC Practice Section of the AICPA related to peer review include the peer review report, the letter of comments, a response by the peer reviewee, and a cover letter from the AICPA. In some cases, an iterative set of correspondence is filed, depicting follow-up reviews due to concerns of either the peer reviewer or the AICPA, as well as disagreements that may arise between the reviewee, reviewer, and the AICPA Committee which exercises oversight of the program. While others have considered the nature of information in public files by focusing on the peer review reports and letters of comment (e.g., see Wallace and Wallace 1990a), to date, little attention has been directed to the other types of correspondence present. Yet, in the course of performing such past research, it has been observed that the cover letter from the AICPA frequently takes on other than a boilerplate format and may lead to some interesting disclosures about the peer reviewee (Wallace 1989).

Specifically, it has been observed that despite the peer reviewer's issuance of an unqualified report, the AICPA oversight committee has frequently called for particular voluntary actions to be taken by the reviewee. Past research has referred to this as an "uncertain" sort of report package (Wallace 1991). Given the peer reviewee is paying for the process, various means of enhancing quality control, beyond material deficiency findings, are no doubt of interest to the CPA firm. Moreover, it may be the case that when marginal judgment calls arise, this sort of modification is a sort of compromise among the parties to achieve the desired remedial action without the issuance of a qualified report. This may facilitate more effective and consistent oversight action by the AICPA in the face of some predictable inconsistency in the judgments made by peer reviewers in diverse settings. In such cases, one might form an expectation that interesting communications could evolve between the peer reviewee and the

AICPA, either prompting the position taken by the AICPA or responding to the requests put forward by such a committee. This highlights the importance of the use of the actual words of the communication. The overall tone of the document will be formed by the use and combination of specific words. Through the tone of the correspondence, both parties will derive their own interpretation of the peer review and subsequent actions or findings. Because the public files contain only summary reports, one must rely on the letters in the file to formulate an overall assessment of the quality and effectiveness of the peer review.

The objective of this research is to explore the nature of such public files through content analysis, both in a computerized form and in a more informal subjective analysis form. This methodology will allow a somewhat objective assessment of a very subjective process—interpretations and tone created by the use of words. In this manner it is possible to draw conclusions from qualitative materials relating to disclosure issues. This type of analysis has the potential to apply to the use of words in any disclosure setting. To make such a task feasible, a core “interesting” sample was targeted. Specifically, all of the AICPA cover letters for the population of AICPA public files for the SEC Practice Section (SECPS) from 1980 through the first quarter of 1986 that differed from a boilerplate format were identified. These were 26 in number, but since two related to revisits, 24 comprise the primary data set for analysis. For these 24 sets of cover letters with reviewee responses, the text was typed and subjected to a computerized content analysis. Due to the limitations of such word-count oriented programs, we also identified expected content from an inferential perspective and then read the data set twice to determine a reasonably consistent subjective coding process.

MOTIVATION

It is our belief that such detailed analyses serve a number of purposes. First, if the AICPA continues to require member firms to include in the public files their response to peer reviewers and the oversight process of the AICPA, then closer scrutiny of such aspects of public files would seem merited. They may well contain evidence as to the nature of the oversight process, the degree to which that process adds specific corrective action steps to the recipient of unqualified,

modified, or adverse reports, and the degree of adversarial interplay between reviewees and the AICPA. Because the quality review process will be administered by a number of state and regional bodies, with some oversight also provided by the AICPA (Huff and Kelley 1989; McCabe 1993), a better understanding of past experiences of the peer review program may enhance the types of information that are gathered (although public files are not expected to be made available for such programs).

Reviewers of public files may get one impression from a peer review report, another from the letter of comments, and yet a third from the response of the reviewee. Then, a fourth complication and perspective is offered by the AICPA whenever other than a boilerplate letter is transmitted to the peer reviewee. Little doubt exists that these last two communications may well alter an initial impression formed by readers of peer review reports. It is also possible that an examination of the reviewee response alone will provide a comprehensive evaluation of the peer review report, in which case a more succinct, yet useful information source is available. We examine whether responses address most of the findings mentioned in the letters of comment.

Reviewees' responses to report findings could identify areas of disagreement with peer reviewers and unusual mitigating circumstances. Moreover, the responses may validate concerns identified by the reviewers. Given the nature of the peer review process, past research has observed that historical files fail to achieve commonality and consistency (Wallace and Wallace 1990b) among the reports and their corresponding letters of comment. Such lack of comparability would seem to intensify the importance of the reviewee response to the public's evaluation of the firm and the quality of the review process. The perceived importance of the response process is evidenced further by the announcement by the AICPA in *The CPA Letter* (AICPA 1994) that a firm had been terminated from the AICPA's Quality Review Program "because the firm failed to revise its letter of response to its quality review, thereby failing to cooperate with the entity administering the review."

Of course, the reviewee responses are not directly comparable and are likely to have a tone that, in part, is influenced by the nature of the findings and type of peer review report received. This supposition is examined. The composition and style of the response letter will contribute to the overall impression created by that letter,

regardless of its content. In light of such a range of possible variation in responses, a content analysis would appear to be the appropriate methodology for exploratory inquiry as to the nature of these public filings. This also allows an investigation as to the degree to which these filings might be expected to potentially influence public opinion, as well as that of various members of oversight groups (assuming an analogous “response by reviewer” mechanism in the quality control process).

From the practitioner’s point of view, the overriding motivation for analyzing reviewee responses is to provide a framework as to how practitioners *should* formulate a response to peer review reports. Does this response have any effect on the AICPA or the public? What is the typical response by firms receiving nonstandard AICPA cover letters?

OBJECTIVE

The objective of the study is to analyze the composition of the peer reviewee’s response letter to provide a basis for anticipating public reaction. The analysis also suggests guidelines as to how practitioners should respond to peer review reports. This type of consideration is appropriately somewhat separate from the content of the letter. As a wide range of individuals will view the letters, each may draw different conclusions, depending on their backgrounds and prior beliefs. Their judgment and intuition will be more apparent in the interpretation of style and tone, rather than in analysis of factual conditions. A secondary objective is to examine the relationship of the cover letter from the AICPA to the reviewee response letter. A third objective is to explore the interrelationship between these correspondence documents in the public file and both the type of peer review report issued and the number of findings listed in the accompanying letters of comment.

RESEARCH DESIGN

The research design consists of a descriptive analysis of 24 peer reviewee response letters to the AICPA (see Appendix for an illustrative letter), and separate consideration of the two filings related only to revisits, that is, to comments from a secondary