

# CPAs must have zero tolerance for failed peer review reports

Recent fine and increase in failed reports point to inadequate implementation of SSARS 19

By Barbara A. Beltrand, vice chair, MNCPA Peer Review Committee  
and Carolee Lindsey, chair, MNCPA Peer Review Committee

The Minnesota Board of Accountancy recently imposed disciplinary action against a firm for a peer review rating of *Fail* for accounting engagements for the period ending July 31, 2011. The firm failed to comply with the applicable quality review requirements as stated in Minnesota statutes and rules. The firm was fined \$1,000, which came as a surprise to many.

In this article, we'll examine recent changes to statutes and the review process and discuss why it's imperative we abide by these standards.

## Carrying the pride of the profession

We all understand that, as CPAs, we should hold ourselves to the highest performance standards. The risk of failing to do so is that we lose the trust and annuity business of recurring engagements with longstanding clients.

Upholding our professional stature is the underlying incentive for CPAs to participate in a peer review program. Bank failures and bankruptcies plagued the business environment in the early 1970s and '80s. The AICPA's Governing Council responded in 1977 by establishing self-regulation. Nevertheless, our profession was prodded to accept and formalize additional responsibilities, and AICPA members voted to approve, effective in January 1988, that AICPA membership requirements include:

- 150 hours of college-level education
- Continuing professional education (CPE)
- Revised code of professional conduct
- Mandatory peer review

CPAs agreed to the mandatory peer review process under the assumption that the program would be non-punitive in the sense that follow-up actions would not be disciplinary in nature but rather *educational*. Instead of fines being

levied against them, firms would be required to participate in CPE and/or pre- and post-issuance reviews. *We would learn and do better in the future.*

In Minnesota, the Minnesota Society of CPAs administers the peer review program (as one of two approved administrators) — through its Peer Review Committee. The Peer Review Committee consists of two Report Acceptance Bodies (RABs). During the past three years, the RABs approved the following peer review results:

Engagement Reviews	2010	2011	2012
Pass	112	89	75
Pass w/ deficiencies	18	21	27
Fail	0	6	10
Total	130	116	112

System Reviews	2010	2011	2012
Pass	76	62	76
Pass w/ deficiencies	9	12	9
Fail	0	2	1
Total	85	76	86

**Engagement reviews** are conducted for firms that perform *as the highest level of service*:

- **Reviews and compilations** under Statements on Standards for Accounting and Review Services (SSARs)
- **Engagements under the Statements on Standards for Attestation Engagements (SSAEs)** (agreed-upon procedures, engagements, financial forecasts and projections, pro forma financial information, compliance attestation)

**System reviews** are conducted for firms that perform:

- **Audits** under Statements on Auditing Standards (SAs) or under Government Auditing Standards (GASs)
- **Examinations** under Statements on Standards for Attestation Engagements (SSAEs)
- **Audits of non-SEC issuers** using Public Company Accounting and Oversight Board (PCAOB standards)

The above statistics note a striking increase in the number of engagement reviews that are characterized as *Fail*. In 2010, there were none; in 2011, there were six (5 percent of the total engagement reviews); and in 2012, there were 10 (9 percent of the total engagement reviews).

## What went wrong?

Despite changes in 2009 for peer review standards that made the likelihood of a *Fail* (formerly called *adverse*) opinion less likely, the failure of firms to implement SSARS 19 has caused increased engagement peer review reports to be characterized as *Fail*.

## SSARS 19

Statement on Standard for Accounting and Reviews Services (SSARS) 19 was effective for compilations and reviews of financial statements for periods ended on or after Dec. 15, 2010. Therefore, SSARS 19 was first effective for calendar year clients for the year ended Dec. 31, 2010.

Many, but not all, compilation and reviews have now filtered through the three-year cycle peer review system in Minnesota. The number of failed reports on *engagement* reviews is uniformly attributable to small firms failing to adequately implement the provisions of SSARS 19.

“ The number of failed reports on engagement reviews is uniformly attributable to small firms failing to adequately implement the provisions of SSARS 19. ”

Of the engagement reviews with a *Fail* report formally accepted by the RABs in 2011, five firms were sole practitioners and one firm had between two and five professionals. In 2012, four firms were sole practitioners, five firms had two to five professionals, and one firm had six to 10 professionals.

Of the 16 failed reports on engagement reviews in 2011 and 2012, *none* used the correct SSARS 19 wording in the compilation or review report, and 14 of the 16 did not have a documented understanding of the engagement with the client. In other words, the report did not have an engagement letter or similar documentation of the understanding of the engagement services.

In addition, three of the 16 had other reporting difficulties, including not addressing all periods presented and not acknowledging a lack of independence. Three others of the 16 had incorrect or missing disclosures, one of the 16 failed to document analytical procedures for a review engagement, and one of the 16 did not present the current portion of long-term debt on a classified balance sheet.

### Explanation of Peer Review standards — and the ratings

Though the argument has been made that the failure to implement multiple components (e.g., the report is incorrect and an engagement letter/documentation of an understanding of the engagement) of SSARS 19 should be judged to be a single deficiency (a SSARS 19 deficiency), such an argument has not prevailed.

Peer review standards indicate that the peer reviewer *must* conclude that a firm has failed an engagement review when “deficiencies are evident on all of the engagements submitted for review.”

### Resources for participants in the peer review process:

Resources about MNCPA and Minnesota Board of Accountancy requirements can be found at <http://www.mncpa.org/resources/peer-review/>.

More granular information about the types of services that fall under the auspices of system reviews versus engagement reviews can be found at <http://bit.ly/12pbiQM>.

Common deficiencies can be found at the Peer Review Program (PRP) Section 6200, Appendix E, Areas of Common Noncompliance with Applicable Professional Standards on page 74 of the Board materials at <http://bit.ly/13DDz8V>.

Visit the following pages to find resources to meet the requirements of Statement on Quality Control Standards (SQCS) No. 8, A Firm’s System of Quality Control. The AICPA provides questionnaires that meet the documentation requirement.

- For a sole practitioner: <http://bit.ly/18bF9AL>
- For a firm with two or more professionals: <http://bit.ly/13DDKRD>

#### *Fail*

If a firm has only one SSARS engagement, it is, of course, the one submitted to the peer reviewer. Such a scenario arises for a small firm that focuses on the provision of tax services. If a firm has only one SSARS engagement with one deficiency, peer review guidance indicates that the deficiency is considered a significant deficiency. A significant deficiency causes the engagement not to be performed and/or reported on in conformity with the standards in all material respects, and the engagement review report is a *Fail*.

#### *Pass with Deficiency*

On the other hand, if a firm performs more than one SSARS engagement, and has a single type of a SSARS 19 deficiency (e.g., the wording of the report does not contain all the critical elements) across all engagements submitted to the peer reviewer, (e.g., multiple instances of the same deficiency) and no other deficiency on any of the submitted engagements, then the firm would have a peer review report of *Pass with Deficiency*.

#### *Considerations for report ratings*

Such results as indicated above have been carefully considered and heavily debated by peer review professionals, the AICPA Peer Review Board (Board), the members of Minnesota’s RABs, and their technical reviewers. In response to concerns raised, the Board, adhering to a principle-based perspective, issued updated guidance in March 2013 to provide a framework for peer reviewers to be more consistent in their assessments of departures from professional standards.

For example, if a report omits non-critical phrases or uses phrases not in conformity with SSARS 19, a Pass report could be deemed appropriate. But if the report departs from the standard wording and does not contain the critical elements mandated by the standards, the peer reviewer should consider whether a *Pass With Deficiencies* or *Fail* report is necessary.

Generally, instances such as a report that is missing critical elements, would suggest the engagement was not performed and/or reported on in conformity with applicable professional standards in all material respects, which would result in a *Pass With Deficiencies* or *Fail* report.

However, if a firm has two SSARS 19 deficiencies, for example, the lack of a documented engagement letter or engagement understanding *and* report language issues, the result is a *Fail*. Remember, the conclusion of the peer reviewer is made in the context of whether the firm performs a single SSARS engagement or multiple SSARS engagements.

In the Peer Review Program (PRP) document that addresses engagement reviews (Section 6200), especially Appendix E, Areas of Common Noncompliance with Applicable Professional Standards (see sidebar on Page 25 for link), the Board specifies matters and findings that result in a *Pass* or a *Fail* report because of problems with:

- Reports
- Financial statement measurement
- Presentation and disclosure
- SSARS procedures (including documentation)

## Boards of Accountancy and the risk of civil penalties

The National Association of State Boards of Accountancy (NASBA), through its Compliance Assurance Committee (CAC), promotes and supports peer review oversight by state boards of accountancy. At this point, about 24 state boards of accountancy have a Peer Review Oversight Committee (PROC).

In Minnesota, an early adopter, the PROC is named the Quality Review Oversight Committee (QROC), which the Minnesota Board of Accountancy appoints. The Minnesota QROC oversees the peer review *process* of the report acceptance bodies of the MNCPA and Minnesota Association of Public Accountants (MAPA).

How to fulfill the QROC's oversight mandate and the Board of Accountancy's mandate to protect the public and the reputation of the CPA profession varies from state to state.

In a recent meeting, for the first time, the Minnesota Board of Accountancy imposed a disciplinary action by levying a civil penalty of \$1,000 for failure

to comply with the applicable quality review requirements as set out in Minnesota statutes and rules because of a peer review rating of *Fail* for accounting engagements for the period ended July 31, 2011.

The specific Minnesota statutes and rules cited in the Stipulation and Consent Order included:

### 2012 Minnesota statutes

- 326A.04 — Certificate issuance and renewal; competency standard
- 326A.05 — Permit to practice as a CPA firm, Subdivision 8. Peer review; rules
- 326A.08 — Enforcement, Subdivision 5. Actions against persons or firms

### Minnesota administrative rules

1105.5600 — Grounds for enforcement action

- Subpart 1. C. (6) **failure to comply with professional standards as to the attest or compilation competency requirement for those who supervise attest or compilation engagements and sign reports on financial statements or other compilation communications with respect to financial statements;**
- Subpart 1. C. (7) **failure to comply with the applicable quality review requirements** set out in this chapter and Minnesota Statutes, sections 326A.04 and 326A.05, subdivision 8.

As Minnesota CPAs, we should note that a failed engagement review does not automatically mean the above statutes and administrative rules will be invoked and that a civil penalty will be imposed by the BOA. ***But we should be aware of this risk.***

## What can you do to help ensure you pass Peer Review?

In short, educate yourself and conform to professional standards.

1. Make sure that the compilation or review report conforms to the required text.
2. Obtain an engagement letter or document your agreement about the engagement with your client.
3. Pay attention to required disclosures and presentation formats (GAAP or other financial reporting framework).
4. Stay current with your CPE and direct your CPE to education about standards that affect your firm's practice areas.
5. Adopt a quality control system (see sidebar on Page 25 for link).
6. Avoid the common errors listed in the AICPA's Peer Review Program (PRP) Section 6200, Appendix E, Areas of Noncompliance with Applicable Professional Standards (see sidebar on Page 25 for link).
7. **If you discover that your firm has not complied with standards, after an engagement is completed, follow the standards for bringing the engagement into compliance, including re-issuing a report.**

Though the imposition of civil penalties by the BOA takes us far beyond the original purpose of peer review as an educational and professional improvement process, the BOA has a duty to enforce statutes and rules related to holding a Minnesota CPA certificate.

A couple of hours of CPE and pre- or post-issuance reviews imposed by peer review look mighty good compared to the public posting of disciplinary actions and the burden of civil penalties.

***Let's be sure that we all pass peer review. ■***

“ Of the 16 failed reports on engagement reviews in 2011 and 2012, none used the correct SSARS 19 wording in the compilation or review report, and 14 of the 16 did not have a documented understanding of the engagement with the client. ”



*Barbara A. Beltrand, MLS, MBA, CPA, is a tenure track faculty member at Metropolitan State University, where she teaches financial accounting and auditing, and is vice chair of the*

*MNCPA Peer Review Committee. She previously worked in a regional firm performing quality reviews of financial reporting engagements. She can be reached at [BarbaraBeltrand@b2beltrand.com](mailto:BarbaraBeltrand@b2beltrand.com).*



*Carolee Lindsey, CPA, partner, Cummings, Keegan & Co., P.L.L.P., specializes in audits, reviews, tax returns and business advisory projects for privately-held companies, and*

*performs peer reviews for a number of CPA firms. Carolee serves on the MNCPA Board and as chair of the MNCPA Peer Review Committee. She can be reached at [clindsey@ckco-cpa.com](mailto:clindsey@ckco-cpa.com).*

*The authors wish to extend appreciation to Faye Hayhurst, director of Finance and Administration at the MNCPA, for her assistance in data collection for this article and invaluable ideas and perspective on this pressing issue for CPAs in Minnesota.*

## Resources to conform to SSARS 19

Visit the AICPA Financial Reporting Center at <http://bit.ly/16uKplW>.

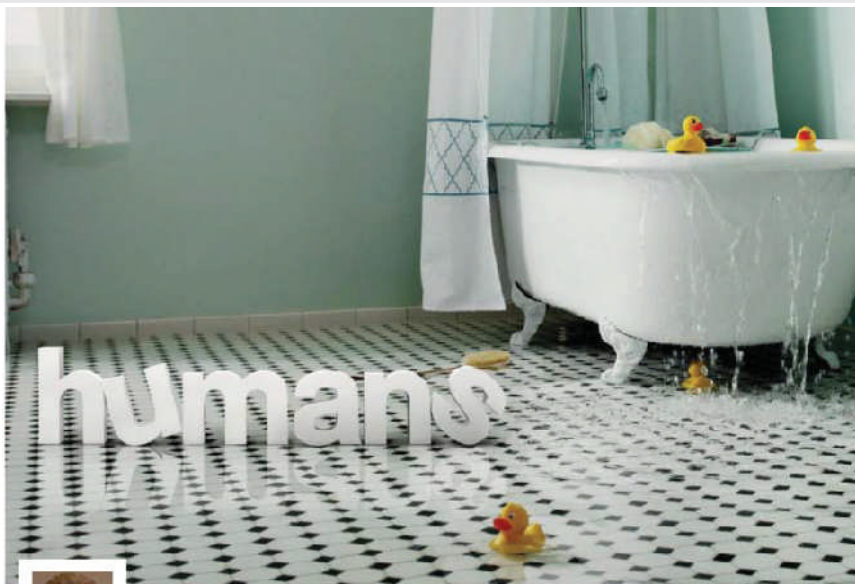
There, you can read about:

- Accounting & Financial Reporting
- Compilation
- Financial Reporting Center
- Industry Insights
- Review
- Audit & Attest
- Assurance & Advisory Services

### Compilations:

To read about AR Section 80, Compilation of Financial Statements (SSARS No. 19), visit <http://bit.ly/1aurFB0>.

For a sample review checklist for a compilation engagement, visit: <http://bit.ly/1brUIbG>.



### Darlene Von Arx

14985 Glazier Ave.  
Apple Valley, MN 55124  
952-891-6363  
[www.LibertyMutual.com/DarleneVonArx](http://www.LibertyMutual.com/DarleneVonArx)  
[Darlene.VonArx@LibertyMutual.com](mailto:Darlene.VonArx@LibertyMutual.com)

## Your home. Your car. Your life. Our business.

Humans. We mean well, but we make mistakes. Fortunately, Liberty Mutual Insurance has 100 years of experience fixing them, offering quality coverage and expert advice for a wide range of insurance products: auto, home, life, condo, renters, umbrella and annuity.

Responsibility. What's your policy?®



**Liberty Mutual.**  
INSURANCE

AUTO | HOME | LIFE

Auto and home coverage is provided by and underwritten by Liberty Mutual Insurance Company and its affiliates, 175 Berkeley Street, Boston, MA 02116. Life insurance and annuity products are offered by Liberty Life Assurance Company of Boston, a member of the Liberty Mutual Group. Home office: Boston, MA. Service center: Dover, NH. © 2012 Liberty Mutual Insurance